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This sixth edition of *The Securities Litigation Review* is a guided introduction to the international varieties of enforcing rights related to the issuance and exchange of publicly traded securities.

Unlike most of its sister international surveys, this review focuses on litigation – how rights are created and vindicated against the backdrop of courtroom proceedings. Accordingly, this volume amounts to a cross-cultural review of the disputing process. While the subject matter is limited to securities litigation, which may well be the world’s most economically significant form of litigation, any survey of litigation is in great part a survey of procedure as much as substance.

As the chapters that follow make clear, there is great international variety in private litigation procedure as a tool for securities enforcement. At one extreme is the United States, with its broad access to courts, relatively permissive pleading requirements, expansive pretrial discovery rules, readily available class action principles and generous fee incentives for plaintiffs’ lawyers. At the other extreme lie jurisdictions such as Sweden, where private securities litigation is narrowly circumscribed by statute and practice, and accordingly quite rare. As the survey reveals, there are many intermediate points in this continuum, as each jurisdiction has evolved a private enforcement regime reflecting its underlying civil litigation system, as well as the imperatives of its securities markets.

This review reveals an equally broad variety of public enforcement regimes. Canada’s highly decentralised system of provincial regulation contrasts with Brazil’s Securities Commission, a powerful centralised regulator that is primarily responsible for creating and enforcing Brazil’s securities rules. Every country has its own idiosyncratic mixture of securities lawmaking institutions; each provides a role for self-regulating bodies and stock exchanges but no two systems are alike. And while the European regulatory schemes have worked to harmonise national rules with Europe-wide directives – an effort now challenged by the departure of the United Kingdom from the European Union – few countries outside Europe have significant institutionalised cross-border enforcement mechanisms, public or private.

We should not, however, let the more obvious dissimilarities of the world’s securities disputing systems obscure the very significant convergence in the objectives and design of international securities litigation. Nearly every jurisdiction in our survey features a national securities regulatory commission, empowered both to make rules and to enforce them. Nearly every jurisdiction focuses securities regulation on the proper disclosure of investment-related information to allow investors to make informed choices, rather than prescribing substantive investment rules. Nearly every jurisdiction provides both civil penalties that allow wronged investors to recover their losses and criminal penalties designed to punish wrongdoers in the more extreme cases.
Equally notable is the fragmented character of securities regulation in nearly every important jurisdiction. Alongside the powerful national regulators are subsidiary bodies – stock exchanges, quasi-governmental organisations, and trade and professional associations – with special authority to issue rules governing the fair trade of securities and to enforce those rules in court or through regulatory proceedings. Just as the world is a patchwork of securities regulators, so too is virtually each individual jurisdiction.

The ambition of this volume is to provide readers with a point of entry to these wide varieties of regulations, regulatory authorities and enforcement mechanisms. The country-by-country treatments that follow are selective rather than comprehensive, designed to facilitate a sophisticated first look at securities regulation in comparative international perspectives, and to provide a high-level road map for lawyers and their clients confronted with a need to prosecute or defend securities litigation in a jurisdiction far from home.

A further ambition of this review is to observe and report important regulatory and litigation trends, both within and among countries. This perspective reveals several significant patterns that cut across jurisdictions. In the years since the financial crisis of 2008, nearly every jurisdiction reported an across-the-board uptick in securities litigation activity – an increase that will likely be recapitulated by the covid-19 pandemic currently roiling society and the global economy. Many of the countries featured in this volume have seen increased public enforcement, notably including more frequent criminal prosecutions for alleged market manipulation and insider trading, often featuring prosecutors seeking heavy fines and even long prison terms.

Civil securities litigation has continued to be a growth industry as a new normal has set in for the private enforcement of securities laws. While class actions are a predominant feature of US securities litigation, there are signs that aggregated damages claims are making significant inroads elsewhere. Class claims are now well established as part of the regulatory landscape in Australia and Canada, and there appears to be accelerating interest around the world in securities class actions and other forms of economically significant private securities litigation. Whether and where this trend takes hold will be one of the important securities law developments to watch in coming years.

This suggests the final ambition for The Securities Litigation Review: to reflect annually where this important area of law has been, and where it is headed. Each chapter contains both a section summarising the year in review – a look back at important recent developments – and an outlook section, looking towards the year ahead. The narrative here, as with the book as a whole, is of both convergence and divergence, continuity and change – with divergence and change particularly predominant in recent years, following political upheaval in the United States and the United Kingdom that has produced a sharp break from international cooperation and forceful government regulation in the global finance capitals of New York and London.

An important example is the matter of cross-border securities litigation, treated by each of our contributors. As economies and commerce in shares become more global, every jurisdiction is confronted with the need to consider cross-border securities litigation. The chapters of this volume show jurisdictions grappling with the problem of adapting national litigation systems to a problem of increasingly international dimensions. How the competing demands of multiple jurisdictions will be satisfied, and how jurisdictions will learn to work with one another in the field of securities regulation, will be a story to watch over the coming years. We look forward to documenting this development and other emerging trends in securities litigation around the world in subsequent editions.
Many thanks to all the superb lawyers who contributed to this sixth edition. For the editor, reviewing these chapters has been a fascinating tour of the securities litigation world, and we hope it will prove to be the same for our readers. Contact information for our contributors is included in Appendix 2. We welcome comments, suggestions and questions, both to create a community of interested practitioners and to ensure that each edition improves on the last.

William Savitt
Wachtell, Lipton, Rosen & Katz
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Chapter 1

SEC ENFORCEMENT: A PRACTICAL GUIDE FOR PRIVATE EQUITY FUND MANAGERS

Eva Ciko Carman, Jason E Brown, Kirsten Boreen Liedl and Daniel Flaherty

I  INTRODUCTION

In recent years, the Securities and Exchange Commission (SEC) has brought a variety of highly publicised enforcement actions against private equity firms. By virtue of the long-tail nature of private equity investments, the cases focus on conflicts arising years after the original investment. Accordingly, these cases were not charged as standard fraud-in-the-sale cases but, rather, were pursued as cases sounding in breach of fiduciary duty. The focus on these cases led to a host of settlements that shed light on the SEC’s current perspective on pursuing private funds and on the development of breach of fiduciary duty principles. These principles are relevant across the spectrum of private funds, including digital asset, real estate, debt and hedge funds. Although the SEC’s priorities for 2020 continue to include focusing on retail investors, the SEC shows no signs of slowing its enforcement actions against private equity fund advisers, and has reaffirmed that it will continue to review conflicts of interest, such as undisclosed or inadequately disclosed fees and expenses and the use of affiliates to provide services to clients. This chapter provides a contextual backdrop for the current enforcement landscape, highlights the key cases and examination trends and offers practical guidance for private fund advisers who wish to assess and remediate their potential vulnerabilities to similar claims.

II  BACKGROUND ON CONFLICTS OF INTEREST AND SEC ENFORCEMENT OF THE PRIVATE EQUITY INDUSTRY

Before 2010, with a few exceptions, private equity fund advisers generally did not register with the SEC and, while still subject to the securities laws, largely operated outside the SEC’s regulatory regime. Nonetheless, issues within the private equity industry were beginning to be identified by both domestic and international entities. For example, in May 2008, the Technical Committee of the International Organization of Securities Commissions (IOSCO) issued a report setting forth perceived regulatory risks in the private equity industry, including increasing leverage, market abuse, conflicts of interest management, transparency, overall

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market efficiency, diverse ownership of economic exposure and market access.3 In November 2009, IOSCO issued a subsequent report focusing on conflicts of interest within the private equity industry, including the use of third-party advisers, lack of disclosure and calculation of fees, which was finalised after public comment in November 2010.4 In May 2011, the SEC cited IOSCO’s final report as a useful public source describing conflicts of interest that private fund advisers may face.5

In March 2012, provisions of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) became effective. Dodd–Frank extended the registration requirements of the Investment Advisers Act of 1940 (the Advisers Act) to most private equity advisers. Around the same time, the SEC’s Division of Enforcement announced the creation of specialised units, such as the Asset Management Unit, to develop expertise on the private equity industry and its common business practices. In addition, the Office of Compliance Inspections and Examinations (OCIE) formed a Private Funds Unit with personnel focusing on private equity firms.

OCIE also began periodic examinations of private equity advisers. In October 2012, in response to the new Dodd–Frank provisions, OCIE began its Presence Exam Initiative among newly registered investment advisers. The purpose of this initiative was, in part, to deepen the SEC’s understanding of the private equity industry and better assess the issues and risks associated with this business model. Over the past few years, OCIE has gained added knowledge about the private equity industry by including industry experts from outside the agency on its teams.

Through examinations, OCIE and the SEC more broadly have identified a number of perceived deficiencies within the private equity industry, and have begun providing guidance to assist private equity advisers in bolstering their compliance programmes. A notable example of this guidance was the highly publicised ‘Sunshine Speech’ by Andrew Bowden, then of OCIE, in May 2014, which made clear that the SEC was focusing, and

would continue to focus on the private equity industry. Similarly, OCIE recently offered an overview of frequent advisory fee and expense compliance issues it encounters, including issues of particular relevance to private equity fund advisers.

One of the common themes discussed in SEC guidance – and seen in examinations and enforcement matters – is that the private equity industry presents unique regulatory challenges and conflicts of interest because of its business model. Private equity investors commit capital for investments that may not produce returns for years. Private equity investors therefore enter into agreements that are intended to govern the terms of their investment throughout the fund’s life, which routinely exceeds 10 years. Unlike many other types of investments, it is difficult for an investor to readily withdraw its capital from a private equity fund investment. Moreover, typical investment advisers generally do not wield significant influence over companies in which their clients invest, and when they do, the adviser’s control is generally visible to its investors and the public. In contrast, the private equity model allows a private equity adviser to use client funds to obtain a controlling interest in a non-publicly traded company, thereby obtaining significant influence over that company. Private equity advisers frequently are very involved in managing investments, such as serving on the company’s board, selecting and monitoring the management team, acting as sounding boards for CEOs, and sometimes assuming management roles. In the Sunshine Speech, Andrew Bowden explained that: ‘[T]he private equity adviser can instruct a portfolio company it controls to hire the adviser, or an affiliate, or a preferred third party, to provide certain services and to set the terms of the engagement, including the price to be paid for the services . . . or to instruct the company to pay certain of the adviser’s bills or to reimburse the adviser for certain expenses incurred in managing its investment in the company . . . or to instruct the company to add to its payroll all of the adviser’s employees who manage the investment.’ Bowden noted that, in his view, this model results in conflicts beyond those faced by typical investment advisers.

Another common theme relates to disclosure. Cases and speeches suggest that, for an adviser to satisfy its fiduciary duty under Section 206 of the Advisers Act, the adviser must disclose all material information at the time investors commit their capital, including potential conflicts of interest. In the SEC’s view, limited partnership agreements often contain insufficient disclosure regarding fees and expenses that could be charged to portfolio companies, as well as allocation of these fees and expenses. The SEC has also indicated that private equity advisers have often used consultants, or ‘operating partners’, who provided consulting services to portfolio companies and were paid directly by portfolio companies or the funds, without sufficient disclosure to investors. There have also been alleged instances of poorly defined valuation procedures, investment strategies and protocols for mitigating

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certain conflicts of interest, including investment and co-investment allocation. Of late, the SEC has signalled interest in potentially inaccurate or inadequate disclosures of emerging investment strategies, such as strategies focused on sustainable and responsible investing, which incorporate environmental, social and governance criteria. In this context, the SEC has suggested that the private equity industry has suffered from an overall lack of transparency. In the SEC’s view, some limited partnership agreements do not provide investors with sufficient information to be able to monitor their investments and the investments of their adviser. Although investors engage in substantial due diligence prior to investing in a fund, because of the unique nature of the private equity model, there has rarely been meaningful investor oversight after closing. This limited oversight has the potential to increase the inherent temptations and risks already present within the private equity model.

Finally, much of the SEC’s focus in the private equity industry has been on conflicts of interest. In a February 2015 speech, the SEC said that nearly all SEC enforcement matters involve examining whether an adviser has a conflict of interest and, if so, whether the adviser eliminated or disclosed that conflict. According to the SEC, conflicts of interest include situations where there is a ‘facial incompatibility of interests, as well as any situation where an adviser’s interests might potentially incline the adviser to act in a way that places its interests above clients’ interests, intentionally or otherwise’. Notably, under this model, a conflict of interest does not require that an investor be harmed by the conflict, or that the adviser intended to cause harm to the investor. It only requires the possibility that an investment adviser’s interests could run counter to those of its investors.

As a result of the SEC’s highly publicised focus on the private equity industry, investment advisers have been reviewing and changing their practices. However, the SEC’s enforcement efforts and focus on the private equity industry have continued and evolved.

The SEC has long categorised its continued enforcement efforts to focus on three groups: advisers that receive undisclosed fees and expenses; advisers that impermissibly shift and misallocate expenses; and advisers that fail to adequately disclose conflicts of interest. These areas of enforcement are still relevant today, as the SEC’s understanding of the adequacy of disclosures and potential for conflicts of interest develops alongside shifts in industry practice. Further, these areas are informative to not only the private equity industry, but also other types of investment advisers who are evaluating their practices and procedures, including those focused on digital assets, real estate, debt and hedge funds. While conflicts of interests were not historically the focus of hedge fund exams, over the past few years, examiners have begun to ask conflict-focused questions – focused on allocation of expenses, allocation of investment opportunities and other conflicts arising, particularly where the hedge fund has a related private equity or debt manager. It is, therefore, important for all advisers to have an understanding of relevant areas of SEC enforcement and potential conflicts of interest, which are described in more detail below.

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8 See above, footnote 2.
9 See above, footnote 6.
10 Id.
III CONFLICTS OF INTEREST

The SEC’s interest in the private equity industry encompasses a wide range of topics, from the highly publicised accelerated monitoring fee issue to the lesser-known conflicts-of-interest issues brought up in examinations. Private equity advisers should be aware of significant areas of enforcement that have increasingly been a subject of SEC focus over the past few years, including undisclosed fees and expenses, misallocation of expenses, valuation of investments and calculation of fees, inadequate disclosure of investments or loans, relationships with third-party service providers, and discounts received from service providers.

While the SEC’s enforcement actions cover just a few of the potential conflicts of interest,11 these actions provide good examples of the SEC’s enforcement approach to conflicts and the evolution of obligations arising from Section 206 of the Advisers Act. Notably, under Section 206, the SEC focuses not only on identification of conflicts, but also on the policies and procedures in place for identifying and mitigating such conflicts.

i Undisclosed fees and expenses

The SEC’s focus on the receipt of undisclosed fees and expenses has been highly publicised. One very notable example is the practice of obtaining accelerated monitoring fees from portfolio companies, which was highlighted by Andrew Bowden in the Sunshine Speech in 2014.

For instance, in a SEC settlement, the SEC alleged that the adviser terminated monitoring agreements with its portfolio companies and accelerated the monitoring payments in these agreements. The adviser had disclosed that it could receive monitoring fees from portfolio companies, and disclosed the amount of the accelerated fees after they had been collected. However, the SEC alleged that the adviser failed to disclose to investors that it would accelerate payment of future monitoring fees upon the sale or initial public offering (IPO) of a portfolio company. By the time disclosure was made of the accelerated fees, limited partners were already committed to the funds and the fees had been paid. The SEC also noted that certain of the adviser’s agreements had ‘evergreen’ provisions that automatically extended the life of the monitoring agreements for an additional term, and that, on occasion, the adviser received fees that surpassed the length of time that it provided monitoring services to the portfolio company. The SEC therefore alleged that the receipt of the accelerated monitoring fees constituted an undisclosed conflict of interest.

In another example arising during the funds’ exit of portfolio positions, the SEC alleged a failure to disclose compensation against MVP Manager, LLC, an unregistered adviser to late-stage venture capital funds.12 The SEC alleged that, in three instances, MVP principals received brokerage commissions from a counterparty selling pre-IPO company securities to MVP’s advisory clients at pre-arranged prices. As described by the SEC, MVP’s failure to disclose the commission agreements created an undisclosed conflict because the MVP principals had an economic incentive to recommend that the funds purchase the securities

11 For example, while no enforcement actions have been brought in the private equity space on stapled secondary transactions, these raise potential conflicts on which the SEC has focused during exams.

at the negotiated price, in order to trigger their receipt of commissions. To settle these allegations, MVP agreed to pay US$150,059 in disgorgement, US$19,681 in prejudgment interest and a US$80,000 in civil penalty.

The SEC also routinely targets undisclosed compensation resulting from a fund’s initial investment. A recent example involved Fortress Investment Management, LLC, the fourth adviser to face charges of undisclosed compensation arising from its funds’ investment in the Aequitas enterprise.13 According to the SEC, Fortress advised a small fund to invest over 95 per cent of its assets into securities issued by an Aequitas entity, without disclosing to the fund’s investors that Fortress received $15,000 per month from an Aequitas affiliate for consulting and business development services, which included introducing prospective investors. The fund’s documents did disclose that Fortress or its personnel ‘may’ work for and receive compensation from companies in which the fund invested, but the SEC concluded this disclosure was ‘insufficient to allow [investors] to provide informed consent to the actual conflict that existed’. As a result, to settle the charges, Fortress agreed to pay US$104,097 in disgorgement, civil penalties and prejudgment interest, while its principal agreed to a US$50,000 civil penalty and a 12-month suspension from the securities industry.

ii Misallocation of expenses

The SEC has made clear that an adviser is required to allocate expenses so that the expenses are borne appropriately and proportionately by the entity that incurred and benefited from the expenses, unless the arrangement is otherwise disclosed to investors. This situation has arisen in a variety of contexts, such as misallocation of expenses between a fund and the adviser, misallocation of expenses between funds and misallocation of expenses where co-investors have invested in a fund investment.

The SEC has found that an adviser is not permitted to allocate its own operating expenses to funds or portfolio companies if this practice has not been disclosed to investors. For example, in the SEC’s settlement with Cherokee Investment Partners and Cherokee Advisers (together, Cherokee),14 the SEC alleged that Cherokee allocated to its funds US$455,698 in consulting, legal and compliance-related expenses incurred in the course of registering as an investment adviser. Cherokee did not disclose to investors that its funds would be charged for the adviser’s legal and compliance expenses. Cherokee ceased this practice in March 2015 and reimbursed the funds for these expenses in April 2015. Nonetheless, because Cherokee had failed to disclose this practice to investors, Cherokee ultimately paid a US$100,000 civil penalty to settle this matter.

Similarly, Potomac Asset Management Company, Inc. (PAMCO) and its president settled allegations that PAMCO, inter alia, improperly used the funds’ assets to pay PAMCO’s adviser-related expenses, including compensating a member of the investment team, paying

rent and other expenses, and paying costs associated with PAMCO’s regulatory obligations.\textsuperscript{15} The funds’ governing documents did not authorise or disclose this practice. To settle these allegations with the SEC, PAMCO agreed to pay a civil penalty of US$300,000.

Increasingly, the SEC is focusing on the specificity with which a fund’s obligation to bear the adviser’s operating expenses has been disclosed. For example, the SEC alleged that First Reserve Management misallocated expenses to funds without making appropriate disclosures or obtaining consent.\textsuperscript{16} First, the SEC alleged that First Reserve misallocated the fees and expenses of two entities formed as advisers to a fund portfolio company, which allowed First Reserve to avoid incurring certain expenses in connection with providing advisory services to the funds. Second, the SEC alleged that First Reserve misallocated premiums for a liability insurance policy covering First Reserve for risks not entirely arising from its management of the funds, when the governing fund documents provided that the funds would only pay insurance expenses relating to the affairs of the funds. To resolve these allegations, among others, First Reserve committed to reimbursing the funds and revising its practices and disclosures, and agreed to pay a civil penalty of US$3.5 million.

Similarly, the SEC alleged that Yucaipa Master Manager, LLC, as manager to several private equity funds, improperly charged those funds US$570,198 in expenses related to tax preparation by in-house employees over a five-year period.\textsuperscript{17} The SEC recognised that the fund agreements obligated the funds to bear the costs of financial statement and tax return preparation, but nonetheless found that the agreements obligated Yucaipa to bear the costs for its affiliates’ normal operating overhead, including employee salaries. Yucaipa’s alleged failure to disclose that it would allocate a portion of the salaries of in-house tax employees preparing fund tax returns to the funds, among other alleged failures discussed below, led to an enforcement action ultimately settled for approximately US$3 million.

The SEC also considers the effectiveness of an adviser’s expenses allocation procedures to ensure compliance with their disclosures. For example, in a recent case involving a fund-of-funds adviser, the SEC agreed to a US$2.73 million settlement of allegations that, among other conduct, the adviser overcharged three funds for the expenses of management employees by failing to adjust compensation-related expenses for time unrelated to the employees’ reimbursable management activity. The funds’ governing documents permitted the adviser to charge the funds for the payroll burden of management employees assisting management entities that control the underlying investments of the fund’s investments. The SEC alleged that approximately 7 per cent of the nearly US$30 million in expenses the funds paid for that management assistance was charged in error for time spent dealing with general fund administration.

Similarly, in a case alleging wide-ranging compliance failures against Corinthian Capital Group, its CEO and CFO, the SEC commented on Corinthian’s improper allocation


of organisational expenses to a fund client.\textsuperscript{18} While the SEC noted that the fund’s documents permit Corinthian to call capital to pay the fund’s organisational expenses, the SEC nonetheless alleged that Corinthian improperly caused the fund to pay organisational expenses by transferring fund assets to itself based on estimated organisational expenses before those expenses were incurred. Further, the SEC alleged Corinthian improperly included placement fees in the amount of organisational expenses, despite their being specifically excluded under the fund documents’ definitions. To settle these charges, among others, Corinthian and its executives agreed to pay a civil penalty of US$140,000.

The SEC has also made clear that an adviser must allocate expenses shared by multiple funds proportionately or in compliance with the governing fund documents. For instance, the SEC charged Lincolnshire Management with misallocating expenses between two portfolio companies.\textsuperscript{19} Lincolnshire had integrated two portfolio companies and managed them as one company, although the two portfolio companies remained distinct legal entities that were owned by two separate funds. However, the SEC alleged that Lincolnshire allocated a disproportionate share of the companies’ joint expenses to one portfolio company, to the detriment of that portfolio company’s fund’s investors. For example, it claimed one portfolio company paid for third-party administrators to provide payroll services, but both portfolio companies used these services. Similarly, it stated that certain employees did work that benefitted both companies, but their salaries were not allocated between the two companies. Lincolnshire agreed to pay US$1.85 million in disgorgement and prejudgment interest, as well as a civil penalty of US$450,000, to resolve these allegations.

In another matter, the SEC determined that a private equity adviser improperly allocated broken deal expenses, where it was not disclosed that funds would pay broken deal expenses for the portion of the investment that would have been allocated to employee co-investors. Specifically, under the limited partnership agreements and private placement memoranda, the funds were responsible for all expenses of the partnership, including broken deal expenses. The adviser did not disclose, however, that the funds would also pay the broken deal expenses for the portion of each investment that would have been allocated to the adviser’s co-investors. As a result, the funds were allocated US$1,811,502 during the relevant time period for broken deal expenses without proper disclosure. The adviser agreed to disgorgement and prejudgment interest of US$1,902,132 and a civil penalty of US$1.5 million to settle these allegations.

iii Valuation and miscalculation of fees

In a similar vein, the SEC has indicated that an adviser is required to accurately calculate its fees, in accordance with disclosures. In light of the illiquid nature of many fund assets, in addition to departures from disclosures, the SEC has expressed concern with the use of bespoke methodologies no investor would reasonably anticipate, and inadequate procedures to guard against inherent conflicts.


\textsuperscript{19} See \textit{In re Lincolnshire Management, Inc.}, Investment Advisers Act of 1940 Release No. 3927, Administrative Proceeding File No. 3-16139 (22 September 2014), available at www.sec.gov/litigation/admin/2014/ia-3927.pdf.\end{flushleft}
For example, in a matter currently being litigated in federal court, the SEC alleged that Greenpoint Asset Management II, LLC and related advisers improperly charged over US$13 million in management fees.\(^{20}\) The SEC alleged that such fees resulted from Greenpoint's inflated valuations of a now-worthless portfolio company and a collection of mineral assets. According to the complaint, Greenpoint unreasonably valued the portfolio company at up to 10 times its purchase price, while knowing that a loan in default put all of the company's assets at risk. Further, in contravention of disclosures that mineral assets would be valued by an independent appraiser, Greenpoint allegedly interfered with appraisals to cause higher appraised values.

The SEC also charged ECP Manager LP for continuing to factor in capital committed to worthless assets when calculating management fees, and thereby overcharging its fund investors by approximately US$102,304.\(^{21}\) The fund's documents allegedly based management fees on capital contributions, but required amounts attributable to worthless assets to be excluded from fee calculations. ECP allegedly included approximately US$3.4 million in capital contributions in fee calculations for a 12-month period, which should have been excluded because they were invested in assets that were written down to zero, and later expired as worthless. ECP agreed to settle these allegations for disgorgement and prejudgment interest of US$122,656 and a civil penalty of US$75,000.

The SEC's focus on valuation extends to other alternative asset classes, which can be instructive for the private equity industry. For example, in its 2019 Enforcement Report, the SEC highlighted as noteworthy a case against Deer Park Road Management Company LP, an adviser with over US$2.5 billion assets under management focused on residential mortgage-backed securities.\(^{22}\) In that case, the SEC alleged, inter alia, that Deer Park failed to adopt policies reasonably designed to fairly value its funds' assets in light of conflicts arising from Deer Park's traders' relationship with pricing vendors, use of valuation models and discretion to determine the fair value assessment of a portion of the positions they managed. Deer Park also allegedly failed to implement its existing valuation policy. There were no allegations that any assets were actually valued inaccurately or resulted in excessive management fees. Rather, the SEC alleged that Deer Park failed to guard against the risk that traders were improperly influencing valuations with reasonably designed compliance controls. To settle these allegations, Deer Park agreed to engage an independent compliance consultant, and to pay a civil penalty of US$5 million.


Undisclosed loans and investments

The SEC considers undisclosed loans and investments, as well as misallocation of investment opportunities, to be a potential conflict of interest. The SEC’s settlement with JH Partners provides a good example. In that matter, the SEC alleged that JH Partners and certain of its principals provided loans to the funds’ portfolio companies, thereby obtaining interests in portfolio companies that were senior to the equity interests held by the funds. JH Partners also allegedly caused more than one of its funds to invest in the same portfolio company at differing priority levels from another fund, which could have potentially favoured one client over another. In the SEC’s view, these undisclosed arrangements could have caused the adviser to favour itself or one of its funds over another fund, as a result of its more senior investment position in the portfolio company. The SEC alleged that JH Partners did not adequately disclose the potential conflicts created by these undisclosed loans to the relevant advisory boards. To settle these allegations, among others, JH Partners agreed to pay a civil penalty of US$225,000.

Another example comes from the SEC’s settlement with Michael Devlin, former managing partner and CCO of Pharos Capital Group, LLC (Pharos). Devlin allegedly arranged for a Pharos-managed fund to purchase notes from an entity owned by a subsidiary of one of the fund’s portfolio companies, and for that subsidiary to use a portion of the proceeds to purchase Devlin’s personal interest in the entity issuing the notes. Although the fund ultimately did not lose money on the notes, Pharos failed to disclose this conflict. To settle these allegations, Devlin personally agreed to pay a civil penalty of US$80,000. In addition, he was barred from the securities industry for at least one year, and indefinitely barred from re-entering the industry in a compliance capacity.

Recently, failure to disclose loans, among other allegations such as undisclosed monitoring fees, led the manager of multiple adviser entities, Tyler Tysdal, to agree to a settlement barring him from the securities industry for at least three years and requiring that he pay US$1,163,099 in disgorgement, interest and civil penalties. In relevant part, the SEC alleged that Tysdal directed that money held by one fund, Cobalt, be loaned — without disclosure and against Cobalt’s stated strategy — to portfolio companies held by another fund, the Impact Opportunities Fund, and that the Impact Opportunities Fund’s debt investments in those portfolio companies be subordinated to the undisclosed loans from Cobalt. The SEC determined that Tysdal’s failure to disclose the loan arrangement to the Impact Opportunities Fund investors, or to obtain their prior informed consent, was fraudulent.

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Undisclosed relationships with third parties

The SEC has also focused in recent years on undisclosed relationships with third parties, including third-party service providers. The SEC has determined that these undisclosed relationships can constitute a conflict of interest, even where the undisclosed relationship does not harm investors.

One recent example of an undisclosed relationship with a third party comes from a resolution with Centre Partners Management.26 In the settlement order, the SEC alleged that Centre Partners failed to disclose relationships between certain of its principals and a third-party information technology service provider, as well as the potential conflicts of interest resulting from these relationships. Specifically, three of Centre Partners’ principals were invested in the service provider, two occupied seats on the provider’s board and the wife of one of the principals was a relative of the provider’s co-founder and CEO. Although Centre Partners provided extensive disclosure on its use of the service provider and its advantages – and neither Centre Partners nor its principals profited from the relationship – the SEC alleged that the lack of disclosure about the relationships between the provider and the Centre Partners principals constituted a conflict of interest. Put differently, the SEC did not allege any actual conflict (i.e., that the terms were off-market, that the services were not appropriate or that the owners profited from the arrangements). Rather, the SEC asserted that, because this relationship constituted a potential material conflict, it should have been presented to the limited partners’ advisory committee under the terms of the limited partnership agreements. To resolve these allegations, Centre Partners agreed to pay a civil penalty of US$50,000.

Similarly, in a case previously mentioned, Yucaipa Master Manager, LLC’s principal allegedly made a personal loan of US$215,000 to the principal at a consulting firm (Firm A) engaged by Yucaipa’s funds.27 The loan to Firm A’s principal was secured by money that might be owed to Firm A by Yucaipa and its affiliates, and was paid by accelerating and offsetting fees Yucaipa’s funds owed to Firm A. The Yucaipa principal also personally invested in another consulting firm (Firm B) servicing both Yucaipa’s funds and his own personal investments, and received a right to 25 per cent of Firm B’s profits. The investment in Firm B did nothing to change or offset the consulting fees Yucaipa funds paid to Firm B. The SEC alleged that Yucaipa did not adequately disclose the conflicts created by these undisclosed relationships. As part of the multimillion-dollar settlement noted above, the SEC required Yucaipa to engage an independent compliance consultant to, among other issues, review its conflicts of interest policies and procedures.

Recently, Steven Bruce and Charter Capital Management, LLC, settled charges of similar issues with SEC.28 In that matter, the SEC alleged that Bruce arranged for two funds advised by Charter to make a US$4 million loan to a Norwegian individual and company, without disclosing to the fund investors that Bruce had lent the Norwegian individual

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27 See above, footnote 17.

US$115,000 of his own money. Ultimately, Bruce agreed to settle these allegations by paying a US$40,000 civil penalty, after already having personally refunded investors over US$184,000 during the SEC's investigation.

This focus on conflicts arising from third-party relationships has extended to hedge funds as well. For example, the SEC alleged that Paritosh Gupta shared confidential information obtained from his employment at a hedge fund with his wife, Nehal Chopra, who worked at Ratan Capital Management LP. Gupta also provided investment recommendations and advice to Chopra and Ratan. The SEC alleged that, by sharing Gupta's employer's confidential information, Gupta violated the Advisers Act. In addition, the SEC alleged that Ratan and Chopra failed to disclose Gupta's role to Ratan's investors. To settle these allegations, among others, Gupta, Chopra and Ratan agreed to pay civil penalties of US$250,000, US$200,000 and US$200,000, respectively.

Similarly, in the real estate arena, the SEC recently settled a case with Talimco, LLC on the basis of its failure to disclose relationships with third parties. The SEC alleged that, to satisfy contractual provisions requiring third-party competitive bids, Talimco arranged for third parties to submit bids for mortgage loan participations held by a Talimco-managed Collateralized Debt Obligation (CDO) before that CDO sold the participations to a Talimco-advised fund, while assuring the third parties that they would not win the auction. The SEC did not allege that the price ultimately favoured one Talimco client over the other. Rather, it focused on Talimco's failure to disclose that its interactions with the bidders deprived the investors of the opportunity to obtain a true market check on the loan participations' price. To settle these allegations, Talimco agreed to cooperate in related investigations and pay US$407,759 in disgorgement, interest and civil penalties.

vi Undisclosed discounts from service providers

The SEC has also considered undisclosed discounts received from third-party service providers to be a conflict of interest. In these situations, the SEC has concluded that, because the adviser is receiving an undisclosed benefit in the form of a discount, the adviser cannot consent to the adviser's practice of receiving the discount on behalf of the funds.

For example, in its settlement order with First Reserve Management, LP (discussed earlier), the SEC alleged, inter alia, that First Reserve arranged for a law firm to provide legal services to both First Reserve and its funds from approximately 2010 to 2014, subject to an adviser-level discount not shared by the funds. The law firm provided significantly more legal work, and generated significantly more legal fees, in connection with the services it provided to the funds. As part of this arrangement, First Reserve negotiated a legal fee discount from the law firm for itself that was based on the large volume of work the law firm performed for the funds. First Reserve did not negotiate a similar discount for the funds. Beginning in early 2013, First Reserve began disclosing in its Form ADV that it could receive service provider discounts that might be more favourable than those received by the funds, but did not disclose that it was, in fact, receiving that discount. Following an OCIE

31 See above, footnote 16.
examination, First Reserve agreed to pay to the funds their pro rata share of the discount First Reserve received from the law firm, and to provide investors with information regarding its planned practices to pass through the adviser-level discount to its funds going forward. The SEC still concluded that, because First Reserve was a beneficiary of this discount, the discount resulted in a conflict of interest, and First Reserve could not consent on behalf of the funds to First Reserve’s practice of accepting the discount.

In another similar example of an undisclosed service provider discount, the SEC alleged that an adviser negotiated a legal services discount arrangement on behalf of itself and its funds, wherein the adviser received a greater discount on legal services than the funds. The differing discount rates were not disclosed to the funds or the limited partners. The SEC alleged that this practice constituted a conflict of interest.

IV KEY TAKEAWAYS AND PRACTICE TIPS

As investment advisers have begun changing their practices to address and prevent the conflicts of interest that have long been the centre of the SEC’s private equity enforcement programme, the SEC shows no signs of shifting its attention from the possible conflicts inherent in the private equity business model, and its wider industry. The SEC’s recent statements, examinations and enforcement actions demonstrate the importance of adequate monitoring, evaluation and disclosure of potential conflicts of interest. Both private equity and other types of advisers should evaluate their practices and procedures for any potential conflicts, keeping in mind the following enforcement trends.

i Mitigate, eliminate or disclose conflicts

Advisers should evaluate any potential conflicts that may exist in their practices, procedures or relationships. If any conflicts exist, advisers should determine whether these conflicts have been adequately disclosed or should be mitigated or eliminated. In particular, advisers should examine their fees and expenses charged to funds and portfolio companies to confirm that the fees and expenses have been adequately described in offering agreements or related disclosure documents, or both. Examples of conflicts in the private equity industry can be found in published enforcement actions, public disclosures and SEC guidance and speeches. An adviser’s counsel is also a good source of this information. If the conflict is not disclosed in the offering documents, consideration should be given to whether a disclosure to Limited Partners or their Advisory Committees may be an option.

ii Lack of harm or benefit may be irrelevant to liability

The SEC does not consider the fact that limited partners were not harmed — or even received a benefit — to be a complete defence to a potential conflict. Therefore, when an adviser evaluates a practice or relationship to determine whether it constitutes a potential conflict of interest, the relevant metric is not only whether the arrangement is to the limited partners’ benefit, but also whether it could appear that the arrangement could affect the adviser’s judgment. In the SEC’s view, because an adviser is a fiduciary, it must disclose all material conflicts of interest so that the client can evaluate the conflict and make an informed decision for itself. Any benefit or lack of harm to a limited partner does not relieve the adviser of this duty to inform. Notably, however, SEC speeches have suggested that a potential benefit to an investor may be relevant in assessing a potential remedy, even if it is not relevant in assessing the adviser’s liability.
Focus on both actual and potential conflicts

The SEC is concerned with both actual and potential conflicts. As seen in the Centre Partners settlement, the SEC has pursued enforcement in situations where there is no actual conflict but the mere potential for a conflict exists. Therefore, an adviser must proactively evaluate its practices, procedures and relationships to determine whether they could possibly tempt the adviser to act in its own best interest over that of its investors.

Disclosures in pre-commitment documents

The SEC has continued to emphasise its view that disclosures regarding potential conflicts of interest should be made in pre-commitment, rather than post-commitment, documents. This includes disclosures in a Form ADV, which have been described in SEC speeches as a ‘positive change’, but ‘not a sufficient remedy’. Post-commitment disclosures have been found generally to be insufficient, according to the SEC, because of the unique nature of the private equity industry. Namely, it is the SEC’s view that if limited partners were aware of potential conflicts of interest before committing capital to the fund, they could have bargained for a different arrangement with the adviser. The SEC has generally not been amenable to arguments that it is unfair for advisers to be held accountable for documents drafted long before the SEC began its focus on private equity. The SEC takes the position that private equity advisers have always been investment advisers subject to the Advisers Act, and were therefore fiduciaries subject to the Advisers Act’s anti-fraud provisions. Notwithstanding this view, the SEC does appear to take into consideration certain other post-commitment disclosures, including limited partner advisory committee disclosures and consents.

Detailed disclosures

The SEC expects disclosures to be as detailed as possible. Disclosures involving broad statements in fund documents may be viewed by the SEC as insufficient if a reasonable investor would not have understood the conflict from reading the disclosure. In fact, the SEC has reached out to investors in certain exams and enforcement actions to confirm whether they understood the conflict at issue. In this regard, the SEC has generally rejected arguments that limited partners are sophisticated investors who are aware of industry practices.

CONCLUSION

The SEC’s pursuit of cases in the private equity context has not only shed light on the type of conduct that the SEC views as most problematic, it has also provided invaluable insight into the SEC’s views of fiduciary duty principles under Section 206 of the Advisers Act. Going forward, it is likely that these principles will influence how the SEC approaches and assesses the conduct of all types of private fund advisers. Accordingly, firms are well served by understanding the lessons learned in the private equity context, and using that insight to assess their own practices – asking whether their conduct may be perceived to constitute a conflict or potential conflict and if so, whether those conflicts have been adequately disclosed. Operating with this awareness and taking a proactive approach to remedy any shortcomings will serve firms well in ensuring they are prepared when the SEC eventually comes knocking.

32 See above, footnote 6.
Chapter 2

AUSTRALIA

Luke Hastings and Andrew Eastwood

I  OVERVIEW

i  Sources of law

The primary source of securities law in Australia is the Corporations Act 2001 (Cth) (the Corporations Act), which covers matters such as members’ rights and remedies, takeovers, continuous disclosure, fundraising and financial services and markets.

The Australian Securities and Investments Commission Act 2001 (Cth) (the ASIC Act) creates a number of bodies relevant to the regulation of securities markets, including the Australian Securities and Investments Commission (ASIC). The Act also imposes a number of statutory prohibitions applicable to financial services and markets.

Australia’s main securities exchange is the Australian Securities Exchange (ASX). As a result, the ASX Listing Rules (governing the manner in which entities listed on the ASX must operate) and the various guidance notes supporting these rules are an important source of regulation.

ASIC supervises conduct on the ASX. Under the Corporations Act, ASIC promulgates and enforces ‘market integrity rules’, which impose obligations on market participants and operators.

ii  Regulatory authorities

ASIC, as the securities regulator in Australia, is responsible for securities market supervision and enforcement. ASIC has administrative, civil and criminal enforcement powers.

ASIC’s civil proceedings normally take the form of enforcement of ‘civil penalty’ provisions. Civil penalties are a hybrid sanction combining both civil and criminal remedies subject to the civil burden of proof. The regime provides a way of enforcing the law when it is not possible or appropriate to bring criminal actions against corporations and their officers. ASIC can also seek coercive civil relief from a court, for instance, to protect assets, compel compliance or to require a correction to a prior misleading statement.

In addition to seeking civil enforcement through the courts, ASIC is able to take administrative action, which includes suspension, cancellation or variation of an Australian Financial Services Licence, banning orders against individuals or accepting an enforceable undertaking (a form of negotiated administrative settlement).2

1 Luke Hastings and Andrew Eastwood are partners at Herbert Smith Freehills. The authors wish to thank Danielle Briers, Alison Cranney, Jedda Elliott, Jordan Phoustanis, Camilla Pondel, Anitha Reddy, Emily Shepherd, Mungo Skyring and Sarah Webster for their assistance in producing this chapter.

As part of its administrative jurisdiction, ASIC can refer matters involving alleged breaches of market integrity rules by market participants or operators to the Markets Disciplinary Panel (the Panel). The Panel is a peer-review body that operates, as far as is practicable, independently of ASIC and is capable of issuing infringement notices.  

ASIC’s administrative powers also extend to issuing infringement notices to listed entities for breaches of their continuous disclosure obligations as an alternative to commencing civil penalty proceedings in less serious cases.

The Office of the Commonwealth Director of Public Prosecutions (CDPP) prosecutes criminal breaches of securities laws. The CDPP is an independent prosecution service responsible for the prosecution of alleged offences against Commonwealth law. As most securities laws are Commonwealth laws, the CDPP is generally responsible for the prosecution of securities crimes. Although ASIC prosecutes some minor regulatory offences on its own behalf, it refers most criminal cases to the CDPP, which determines whether to commence criminal proceedings and prosecute any case that goes to trial.

### iii Common securities claims

#### Insider trading and market manipulation

Insider trading and market manipulation are prohibited under Australian law. Insider trading consists of trading in securities while in possession of non-public information that, if it were made public, a reasonable person would expect to have a material effect on the price or value of the securities. It is the possession of material non-public information that makes a person an insider. It is not necessary for the trader to be an insider in the sense of having a fiduciary or other relationship with the issuer of the securities. The application of the prohibitions on insider trading are broad, covering any financial product that is able to be traded on a financial market.

Market manipulation occurs when a person engages in activity that has or is likely to have the effect of creating or maintaining an artificial price for trading in financial products or on a financial market. As for what constitutes an artificial price, it is sufficient to show that the sole or dominant purpose of a trade was to create or maintain a particular price for those securities.

The prohibitions on insider trading and market manipulation extend beyond equity securities markets. The application of the provisions is broad, covering any financial product that is able to be traded on a financial market.

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4 Corporations Act 2001 (Cth) Section 1317DAC. See also ASIC, ‘Regulatory Guide 73: Continuous disclosure obligations: infringement notices’ (October 2017), Paragraphs 1–4.
5 ASIC, ‘Information Sheet 151: ASIC’s approach to enforcement’ (September 2013), p. 5.
7 Director of Public Prosecutions (Cth) v. JM (2013) 250 CLR 135, 168 at [76] (per French CJ, Hayne, Crennan, Kiefel, Bell, Gageler and Keane JJ).
**Liability for misstatements and non-disclosure**

Civil or criminal liability for either making statements relating to securities that are misleading or for failing to disclose information relating to securities in circumstances where disclosure is required can arise under a variety of statutory prohibitions. Although civil liability for losses resulting from a wrong committed in relation to securities disclosures can exist under common law and equity, statutory claims are generally more advantageous for prospective plaintiffs. In particular, a claim for statutory misleading or deceptive conduct generally depends on the effect or probable effect of the conduct rather than on the state of mind of, or lack of care by, the person engaging in the misleading or deceptive conduct.

A listed issuer has a continuous disclosure obligation, which requires it to immediately notify the exchange of any information of which it is aware that a reasonable person would expect to have a material effect on the price or value of the issuer’s securities. Breach of this obligation is often relied upon as a basis for the commencement of securities litigation, both by the regulator and by private litigants.

**Secondary liability and gatekeepers**

Civil liability for certain breaches of duty under the Corporations Act, including a company’s continuous disclosure obligation, can extend to any party ‘involved’ in the contravention. Criminal liability can also extend to accomplices. Similarly, where conduct involves the breach of a director or officer’s duties to the company of care, diligence, good faith or fidelity, that director or officer and anyone involved in the contravention will be liable. This includes liability for a civil penalty from public enforcement and for damages from a private action.

Directors, auditors and professional advisers are viewed by ASIC as ‘gatekeepers’, in the sense that they are an independent corporate monitor capable of ‘closing the gate’ on wrongdoing. In this respect, gatekeepers are expected to play an almost co-regulatory role

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10 ASX, Listing Rules (14 April 2014) Rule 3.1 (given statutory force by the Corporations Act 2001 (Cth) Section 674). Exceptions to this obligation arise under Rule 3.1A if the information is confidential, a reasonable person would not expect it to be disclosed and one or more of the following situations applies: a it would be a breach of a law to disclose the information; b the information concerns an incomplete proposal or negotiation; c the information comprises matters of supposition or is insufficiently definite to warrant disclosure; d the information is generated for the internal management purposes of the entity; or e the information is a trade secret.
11 Corporations Act 2001 (Cth) Sections 79, 181 and 674.
12 Under Section 11.2 of the Schedule to the Criminal Code Act 1995 (Cth), a person who ‘aids, abets, counsels or procures the commission of the offence by another person’ is taken to have committed the offence.
13 Corporations Act 2001 (Cth) Section 181.
with ASIC. For this reason, ASIC has been clear that it will take enforcement action against gatekeepers who do not take their responsibilities seriously and discharge their duties carefully where this has permitted wrongdoing to occur.14

ASIC has brought a number of high-profile civil penalty actions against directors, management and individual auditors for alleged breaches of duty in connection with corporate disclosure.15 Directors and auditors have also had to contribute to compensation for affected investors as a result of class actions or ASIC proceedings.16

II PRIVATE ENFORCEMENT

i Forms of action

In Australia, shareholder class actions17 are the most prevalent and significant type of private securities litigation, although securities litigation can also take the form of individual or derivative action.

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14 See, for example: ASIC, ‘Decision in Centro civil penalty case’ (11-125MR, 24 June 2011); ASIC, ‘ASIC enforcement outcomes: January to June 2015’ (Report No. 444, August 2015), p. 19; ASIC, ‘ASIC enforcement outcomes: July to December 2015’ (Report No. 476, March 2016); ASIC enforcement outcomes: January to June 2017’ (Report No. 536, August 2017); Medcraft, ‘ASIC explained: who is the corporate watchdog, what does it do and why should Australians care?’ (speech delivered at the National Press Club of Australia, Canberra, 3 December 2014).

15 See, for example: ASIC, ‘Macquarie Investment Management penalised over Corporations Act contraventions’ (16-271MR, 24 August 2016); ASIC, ‘Former Kleenmaid director sentenced to nine years imprisonment for fraud and insolvent trading’ (16-257MR, 15 August 2016); ASIC, ‘MFS executives found to have dishonestly breached duties’ (16-158MR, 23 May 2016); ASIC, ‘ASIC bans former director of Provident Capital Limited’ (15-199MR, 28 July 2015); ASIC, ‘Former Chief Financial Officer of ABC Learning Centres sentenced’ (15-073MR, 31 March 2015); and the following ASIC media releases on the Centro, James Hardie and Fortescue Metals Group cases: ‘ASIC commences proceedings against current and former officers of Centro’ (09-202AD, 21 October 2009); ‘Decision in Centro civil penalty case’ (11-125MR, 24 June 2011); ‘Centro civil penalty proceedings’ (11-188MR, 31 August 2011); ‘Former Centro auditor suspended’ (12-288MR, 19 November 2012); ‘James Hardie civil penalty proceedings’ (09-152, 20 August 2009); ‘Decisions in James Hardie civil penalty case’ (10-273MR, 17 December 2010); ‘Decision in James Hardie penalty proceedings’ (12-275MR, 13 November 2012); ‘ASIC commences proceedings against Fortescue Metals Group and Andrew Forrest’ (06-062, 2 March 2006); ‘ASIC takes action against Fortescue Metals and CEO Andrew Forrest’ (MR09-55, 3 April 2009); ‘ASIC’s proceedings against Fortescue Metals Group Ltd and Andrew Forrest dismissed’ (09-268AD, 23 December 2009); ‘Decision in High Court appeal by Fortescue Metals Group and Andrew Forrest’ (12-244MR, 2 October 2012). 


17 For the purposes of this chapter, representative proceedings will be referred to by the more commonly understood title of ‘class actions’.
Shareholder class actions

Shareholder class actions can be commenced via the opt-out representative procedure that exists in Australia under Commonwealth legislation\(^{18}\) and under the almost identical Victorian\(^ {19}\), New South Wales\(^{20}\) and Queensland\(^{21}\) legislation.\(^{22}\) A similar regime has been introduced in Western Australia through the Civil Procedure (Representative Proceedings) Bill 2019 (WA), following recommendations by the Law Reform Commission of Western Australia,\(^ {23}\) but is yet to be enacted.

The most common causes of action relied upon are breach by a company of the continuous disclosure provisions of the Corporations Act\(^{24}\) and breach by a company of the misleading or deceptive conduct provisions of the Corporations Act and ASIC Act.\(^ {25}\) These causes of action are often pleaded together.

Shareholders who suffer loss as a result of this corporate misconduct may bring an action for damages either individually or by way of a class action (the latter often being the more commercial option).\(^ {26}\)

A shareholder class action is typically brought by a representative party on behalf of a group of shareholders who have purchased shares in a listed company during a specified period. Typically, the representative party will allege that:

\( a \) the company was aware of material, price-sensitive information that it failed to disclose to the market;

\( b \) the failure to disclose caused the company’s share price to trade on the market at an inflated price during the period of non-disclosure; and

\( c \) it and other group members acquired shares during the period of non-disclosure at an inflated price and, as a result, suffered loss by ‘overpaying’ for the shares they acquired.

The Australian third-party funding industry is well established. The majority of shareholder class actions in recent years have been funded by a third party (although there are exceptions). The industry has enjoyed significant growth, in particular since a 2006 High Court of Australia (the High Court) ruling that held that litigation funding was not an abuse of process\(^ {27}\) and a 2007 Federal Court of Australia (the Federal Court) ruling that permitted a class to be defined by reference to whether members had signed a funding agreement, thus effectively permitting opt-in or ‘closed’ classes (and excluding ‘free riders’).\(^ {28}\)

A 2016 Federal Court ruling fostered growth in the litigation funding industry by confirming that the Court had the power to make a ‘common fund’ order under s 33ZF

\(^{18}\) Federal Court of Australia Act 1976 (Cth) Part IVA, which was introduced in 1992.

\(^{19}\) Supreme Court Act 1986 (Vic) Part 4A, which was introduced in 2000.

\(^{20}\) Civil Procedure Act 2005 (NSW) Part 10, which was introduced in 2010.

\(^{21}\) Civil Proceedings Act 2011 (QLD) Part 13A, which was introduced in 2016.

\(^{22}\) See generally, Grave, Adams and Betts, Class Actions in Australia (2nd edn, Thomson Reuters, 2012).

\(^{23}\) Law Reform Commission of Western Australia, Representative Proceedings: Project 103 – Final Report (June 2015).

\(^{24}\) Corporations Act 2001 (Cth) Section 674(2).

\(^{25}\) Corporations Act 2001 (Cth) Section 1041H; Australian Securities and Investments Commission Act (Cth) Section 12DA.

\(^{26}\) Corporations Act 2001 (Cth) Sections 1041I and 1317HA.

\(^{27}\) Campbells Cash and Carry Pty Ltd v. Fostif Pty Ltd (2006) 229 CLR 386.

of the Federal Court of Australia Act.\textsuperscript{29} Under a common fund order, all claimants in a class action funded by a litigation funder would be required to contribute to the common fund out of any proceeds received (regardless of whether they had entered into the funding agreement), and that the contribution amount was to be determined by the Court, not the funder. This removed an obstacle for litigation funders who, prior to common fund orders, had to enter into separate funding agreements with every claimant to extract a commission. However, in December 2019, this position was overruled by the High Court of Australia, which held that the courts do not have power to make common fund orders under s 33ZF of the Federal Court of Australia Act (or equivalent provisions).\textsuperscript{30} See section V. i below for more detail on this decision.

\textbf{Statutory derivative action}

The Corporations Act provides individual shareholders with the right to bring a statutory derivative action on behalf of a company in respect of any cause of action that the company has.\textsuperscript{31} The action is commenced with the company as the plaintiff. Actions against one or more directors for breach of directors' duties are commonly brought as a derivative action by shareholders.\textsuperscript{32}

\textbf{ii Procedure}

\textbf{Shareholder class actions}

To commence a class action in the Federal Court, the following threshold criteria must be satisfied:
\begin{itemize}
\item[a] seven or more persons must have claims against the same person or persons;
\item[b] the claims must be in respect of the same, similar or related circumstances; and
\item[c] the claims must give rise to a substantial common issue of law or fact.\textsuperscript{33}
\end{itemize}

In circumstances where there are multiple respondents, every group member is not required to have a claim against each of the respondents to the proceeding.\textsuperscript{34} Further:
\begin{itemize}
\item[a] one or more representative parties (known as the applicant) bring the action against a respondent on behalf of the entire group;
\item[b] there is no certification requirement;
\end{itemize}

\textsuperscript{29} \textit{Money Max Int Pty Ltd (trustee) v QBE Insurance Group Limited} (2016) 245 FCR 191.

\textsuperscript{30} \textit{BMW Australia Ltd v Brewster \& Anor and Westpac Banking Corporation \& Anor v Lenthall \& Ors} [2019] HCA 45

\textsuperscript{31} Corporations Act 2001 (Cth) Sections 236 and 237.

\textsuperscript{32} See Ramsay and Saunders, 'Litigation by shareholders and directors: an empirical study of the statutory derivative action' (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, 2006), p. 29.

\textsuperscript{33} Federal Court of Australia Act 1976 (Cth) Section 33C. While the Federal Court is the most popular forum for class actions in Australia, there are also class action regimes in the Supreme Court of Victoria, the Supreme Court of New South Wales and the Supreme Court of Queensland, which are almost identical to the federal regime; see \textit{Supreme Court Act 1986} (Vic) Part 4A, \textit{Civil Procedure Act 2005} (NSW) Part 10 and \textit{Civil Proceedings Act 2011} (QLD) Part 13A.

the consent of the group members is not required, and group members are not required to be individually identified; and
before the trial of common issues, group members must be notified of the proceedings and have the right to opt out (any judgment will bind all group members who have not opted out).

The threshold for commencing a class action is low and easy to satisfy. However, a respondent may bring an interlocutory application to challenge a class action for failing to meet the threshold criteria. A respondent may also challenge a class action on the basis that:
- the costs that would be incurred if the proceeding continued as a class action are likely to exceed the costs that would be incurred if each group member commenced separate proceedings;
- all the relief sought can be obtained by means of proceedings other than a class action;
- the class action will not provide an efficient and effective means of dealing with the claims of group members; or
- it is otherwise inappropriate for claims to be pursued by means of a class action.

The Federal Court may also, of its own motion, order the discontinuance of the proceeding in these circumstances. A class action in the Federal Court progresses in the same way as any other Federal Court proceeding but with a number of procedural overlays. These include:
- certain notifications to group members;
- court approval for any settlement (see Section II.iii) and distribution regimes; and
- if settlement is not reached, trial of common issues and following the trial of common issues, the determination of individual claims (which may involve separate individual trials).

In December 2019, the Federal Court introduced an updated general practice note on class actions (GPN-CA), which sets out the Court’s approach to case management of class actions and representative proceedings. This includes:
- disclosure to the Court of competing class actions and the expectations of each party;
- the process by which class actions are allocated to a docket judge and, in appropriate cases, to a designated case management judge or a registrar, or both;
- case management procedures, including procedures to be adopted in situations where there are competing class actions;
- disclosure requirements relating to costs agreements and litigation funding agreements, which regulate disclosures to class members, the Court and other parties;
- guidance on communication with class members; and

35 Unless the group member is a governmental or quasi-governmental body or officer, in which case written consent is required pursuant to Section 33E(2).
36 See generally, Federal Court of Australia Act 1976 (Cth) Part IVA and, in particular, Sections 33E, 33H, 33J, 33X and 33ZB.
37 See Federal Court of Australia Act 1976 (Cth), in particular Section 33N(1). For the equivalent state provisions, see Supreme Court Act 1986 (Vic) Section 33N(1), Civil Procedure Act 2005 (NSW) Section 166(1) and Civil Proceedings Act 2011 (QLD) Section 103(K).
38 See Federal Court of Australia Act 1976 (Cth) Section 33N(1).
39 See generally, ibid., Part IVA and, in particular, Sections 33Q, 33R, 33V and 33X.
40 See Federal Court of Australia Practice Note GPN-CA.
issues the Court will determine with competing class actions, including any matter relevant to the settling of a timetable for the efficient conduct of the competing class actions.

As group members are not parties to the class action proceeding, their role in the proceeding is generally passive until the conclusion of the trial of common issues. Accordingly, discovery is usually limited to documents in the possession, custody or control of the representative party. As such, attempts by respondents to seek information regarding the identity of group members and the quantum of their individual claims is an emerging feature of shareholder class actions in Australia. This information may be sought through several means, including requests for further and better particulars of the applicant’s statement of claim, an application for discovery, or by agreement between the parties.

Statutory derivative action

To commence a derivative action, an individual shareholder must obtain the leave of the court. Leave must be granted where the court is satisfied of the following matters:

a. it is probable that the company will not itself bring, or take proper responsibility for, the proceeding;
b. the applicant is acting in good faith;
c. it is in the best interests of the company that the applicant be granted leave;
d. there is a serious question to be tried; and
e. either the applicant gave 14 days’ notice of the application to the company or it is appropriate to grant leave even though the applicant did not give the required notice.

Assuming that an applicant has obtained the leave of the court to bring a statutory derivative action, the usual Australian litigation procedure applies.

iii Settlements

Shareholder class actions

Settlement of a class action in the Federal Court must be approved by the Court at a settlement approval hearing. Notice must be given to group members of the proposed settlement.

In exercising its discretion to approve a settlement agreement, the Court performs a protective function in the interests of group members. Approval will only be granted to a settlement where the settlement is fair and reasonable having regard to the claims of the group members who will be bound by it (both as between the parties to the litigation and as between individual group members). The Court is unlikely to approve a proposed settlement that does not take into account the relative strengths and weaknesses of each individual group member’s claim.

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42 To date such applications for discovery have generally been unsuccessful: Pathway Investments Pty Ltd & Anor v. National Australia Bank Limited [2012] VSC 72.
43 Corporations Act 2001 (Cth) Section 237.
44 Federal Court of Australia Act 1976 (Cth) Sections 33V and 33X.
Statutory derivative action

A statutory derivative action brought under the Corporations Act can only be settled or discontinued with the leave of the court.47 This aims to prevent the defendant and applicant from agreeing to settle the proceedings where it would not be in the best interests of the company (as may occur if the defendant provides a personal incentive, such as a monetary payment, to the applicant to settle).48

iv Damages and remedies

Shareholder class actions

To succeed in a shareholder class action seeking damages for breach of continuous disclosure obligations or misleading or deceptive conduct by a company, the applicant must show a causal connection between the loss suffered and the alleged misconduct. The loss must ‘result from’,49 or a person must suffer loss ‘by’,50 the conduct that has contravened the relevant statutory provisions.

In the context of Australian shareholder class actions, applicants have adopted two different theories to satisfy this requirement:

a applicants allege that they detrimentally relied on the misrepresentations or omissions of the company; or

b a ‘mere inflation’ approach or ‘market-based’ causation (which is based on elements of the US ‘fraud on the market’ theory), where applicants assert that they suffered loss by purchasing shares at a price that was artificially inflated as a result of the misrepresentations or omissions of the company. This approach does not require the applicant to plead that he or she actually read and relied on the disclosures or representations.

The appropriate test for causation in the context of a shareholder class action remains controversial.51 While the reliance-based approach is consistent with ordinary Australian principles of causation, most shareholder class action claims also plead market-based causation. However, market-based causation has received recent judicial support,52 and there now seems to be tentative judicial encouragement to its proponents, potentially signalling further cases that rely on an indirect causation argument.

47 Corporations Act 2001 (Cth) Section 240.
49 In the context of continuous disclosure provisions, Corporations Act 2001 (Cth) Section 1317HA states relevantly: ‘A Court may order a person . . . to compensate another person . . . for damage suffered . . . if: . . . the damage resulted from the contravention’ (emphasis added).
50 In the context of misleading or deceptive conduct provisions, Corporations Act 2001 (Cth) Section 1041I provides: ‘A person who suffers loss or damage by conduct of another person that was engaged in contravention of Section 1041E, 1041F, 1041G or 1041H may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention’.

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In Australia, damages are generally limited to economic loss; punitive damages are not generally available.

It is likely an Australian court would calculate loss as being the difference between the price at which the shareholder acquired their interest and an alternative measure of the value of the security, such as its ‘true’ or ‘market’ value in the absence of the contravening conduct by the company. Shareholder class action claims traditionally plead several different loss methodologies.

Statutory derivative action

In the context of statutory derivative actions, the remedy available to the company depends upon the cause of action claimed in the proceedings. Where derivative proceedings allege a breach of a civil penalty provision of the Corporations Act (such as a breach of directors’ duties), the company may apply for a statutory compensation order requiring the defendant to compensate the company for damage suffered as a result of the breach. In calculating the damage suffered for a breach of directors’ duties, the court may include profits made by the director or any other person resulting from the breach.

III PUBLIC ENFORCEMENT

i Forms of action

ASIC has a broad range of criminal, civil and administrative enforcement options available to it to address securities market misconduct, including:

- commencing criminal prosecutions or referring matters to the CDPP to commence a criminal prosecution;
- commencing civil proceedings for a pecuniary penalty;
- applying to the court for an extensive range of non-pecuniary remedies, including declarations of contravention, compensation orders and injunctions;
- intervening in other civil proceedings;
- administrative action, such as issuing an infringement notice, suspending, cancelling or varying an Australian Financial Services Licence, banning individuals, referring a matter to the Panel or accepting an enforceable undertaking; and
- reporting serious contraventions of the law to the Minister responsible for ASIC (currently the Treasurer), Australian Federal Police, the CEO of the Australian Criminal Intelligence Commission, the CDPP or a prescribed agency.

54 Corporations Act 2001 (Cth) Sections 1317H(1) and 1317J(2).
55 Ibid., Section 1317H(2).
56 ASIC, ‘Information Sheet 151: ASIC’s approach to enforcement’ (September 2013); ASIC, ‘Information Sheet 180: ASIC’s approach to involvement in private court proceedings’ (June 2013); Australian Securities and Investments Commission Act 2001 (Cth) Section 18.
procedure

Civil and criminal proceedings

ASIC’s Office of Enforcement, established in 2019, is responsible for carrying out ASIC’s key enforcement activities and is functionally separate from ASIC’s regulatory teams. It is composed of two specialist enforcement teams – Markets Enforcement and Financial Services Enforcement – and an Enforcement Oversight Committee. ASIC’s enforcement work has a core focus on deterrence, public denunciation and punishment.

When considering whether to initiate civil proceedings, ASIC must be satisfied, after obtaining written legal advice, that it is the most suitable method of enforcement. ASIC has a unique information advantage when making this determination as compared to private litigants. ASIC has the ability to extensively investigate alleged contraventions before commencing enforcement action, using its broad information-gathering powers, which include the power to:

- issue notices to produce;
- apply for search warrants; and
- conduct compelled witness examinations under oath (transcripts of which are admissible in certain civil proceedings).

ASIC does not have the power to apply for warrants to intercept phone calls. However, it does have the power to apply for warrants to obtain stored telecommunications data from service providers. It may also conduct joint investigations into suspected insider trading and market manipulation offences with the Australian Federal Police, which does have the power to apply for warrants to intercept telecommunications. Since 18 February 2020, ASIC has also had the power to receive and use lawfully intercepted telecommunications information in investigating and prosecuting serious offences.

In the context of compelled witness examinations and notices to produce, individuals cannot rely on the privilege against self-incrimination as a basis for refusing or failing to provide the information requested by ASIC. However, such information will generally be

58 ibid.
59 ibid.
60 Legal Services Directions 2017 (Cth) Schedule 1, Parts 1 and 4; Senate Economics References Committee, Parliament of Australia, Performance of the Australian Securities and Investments Commission (June 2014), p. 261.
64 ASIC, ‘Information Sheet 145: ASIC’s compulsory information gathering powers’ (March 2020).
65 ibid.
66 Telecommunications (Interception and Access) Act 1979 (Cch), Sections 67(3) and 68(p), introduced on 18 February 2020 by the Financial Sector Reform (Hayne Royal Commission Response - Stronger Regulators (2019 Measures)) Act 2020 (Cch).
inadmissible as evidence in any criminal proceeding or proceeding for the imposition of a penalty against the individual.\textsuperscript{67} It should be noted that corporations are not protected by the privilege against self-incrimination.\textsuperscript{68}

ASIC cannot compel the production of documents protected by legal professional privilege; however, ASIC may seek voluntary disclosure of privileged communications.\textsuperscript{69}

If ASIC considers that it has sufficient evidence of a criminal offence and the circumstances of the matter warrant a criminal prosecution, it will normally refer the matter to the CDPP.\textsuperscript{70} ASIC will generally consider criminal action for offences involving serious conduct that is dishonest, intentional or reckless, even where there is a civil remedy available for the same conduct.\textsuperscript{71} The CDPP ultimately determines whether to commence a criminal prosecution.\textsuperscript{72}

To ensure a fair trial, the CDPP is subject to higher disclosure obligations than parties to civil litigation. This generally includes informing the accused of:

- the case to be made against them;
- information relating to the credibility or reliability of prosecution witnesses; and
- information that has been gathered through the investigation but on which the prosecution does not intend to rely, or that runs counter to the prosecution case.\textsuperscript{73}

At trial, the CDPP must meet the criminal standard of proof for each charge (beyond reasonable doubt).

In civil penalty proceedings, ASIC must first apply to the court for a declaration that the defendant has contravened a ‘financial services civil penalty provision’.\textsuperscript{74} Following the declaration, ASIC can then pursue a pecuniary penalty order, which may be granted if the contravention:

- materially prejudices the interest of acquirers or disposers of the relevant security;
- materially prejudices the issuer of the relevant security or its members; or
- is serious.\textsuperscript{75}

Civil actions only require proof on ‘the balance of probabilities’. This lower threshold makes it easier for ASIC to obtain an enforcement outcome in civil cases.\textsuperscript{76}

\textsuperscript{67} Australian Securities and Investments Commission Act 2001 (Cth) Section 68.
\textsuperscript{68} Corporations Act 2001 (Cth) Section 1316A.
\textsuperscript{69} See ASIC, ‘Information Sheet 165: Claims of legal professional privilege’ (December 2012); and Eastwood, ‘Providing your legal advice to the regulator’ (2013), 41 \textit{Australian Business Law Review} 66; ASIC, ‘Information Sheet 242: ASIC’s document production guidelines’ (March 2020) paragraphs 56 and 85 to 89.
\textsuperscript{70} ASIC, ‘Information Sheet 151: ASIC’s approach to enforcement’ (September 2013), p. 5; ASIC Commissioner Sean Hughes, ‘ASIC’s approach to enforcement after the Royal Commission’ (speech delivered at the 36th Annual Conference of the Banking and Financial Services Law Association, Gold Coast, Queensland, August 2019).
\textsuperscript{71} ASIC, ‘Information Sheet 151: ASIC’s approach to enforcement’ (September 2013), p. 5.
\textsuperscript{73} ibid.
\textsuperscript{73} See Commonwealth Director of Public Prosecutions, Statement on disclosure in prosecutions conducted by the Commonwealth (22 March 2017), pp. 3–5.
\textsuperscript{74} Corporations Act 2001 (Cth) Section 1317G(1)(a).
\textsuperscript{75} Corporations Act 2001 (Cth) Section 1317G(1)(c).
\textsuperscript{76} It should be noted that ASIC is bound by a ‘model litigant obligation’ when conducting civil proceedings – see Legal Services Directions 2017 (Cth) Schedule 1, Parts 1 and 4; Appendix B.
The court cannot make a declaration of contravention or order a pecuniary penalty if the defendant has already been convicted of an offence for substantially the same conduct.\textsuperscript{77} There is no reverse prohibition for criminal proceedings following a civil action, although evidence given in civil penalty proceedings is not admissible in subsequent criminal proceedings.\textsuperscript{78}

Civil penalty and criminal prosecution of contraventions of securities laws may affect the outcome of private proceedings because ASIC regularly provides transcripts of its compelled examinations to class action law firms and liquidators,\textsuperscript{79} and findings of fact made by a court in a civil penalty proceeding may be used as evidence of that fact in certain private actions for damages.\textsuperscript{80}

**Infringement notices**

ASIC may issue an infringement notice to a listed entity for less serious breaches of its continuous disclosure obligations under the Corporations Act if it has reasonable grounds to believe the entity has contravened those obligations.\textsuperscript{81} The infringement notice will provide for the payment of a penalty.\textsuperscript{82}

In March 2019, the infringement notice regime was expanded to include all strict and absolute liability offences in the Corporations Act, and certain other provisions.\textsuperscript{83}

In determining whether to issue an infringement notice, ASIC will consider the relevant facts and circumstances of the matter, and generally have regard to the seriousness of the alleged breach and the view of the relevant market operator.\textsuperscript{84}

ASIC will only issue an infringement notice in respect of breaches of continuous disclosure obligations after conducting a private hearing at which the entity may give evidence and make submissions.\textsuperscript{85} This requirement does not apply to the expanded infringement notice regime introduced in March 2019, but recipients of an infringement notice under that regime may apply to ASIC within 28 days to seek withdrawal of the notice.\textsuperscript{86}

The entity can elect whether or not to comply with the infringement notice and pay the penalty. If the entity does comply, ASIC cannot commence civil or criminal proceedings against the entity (subject to certain exceptions),\textsuperscript{87} and the entity will not be regarded as having contravened the provision specified in the notice.\textsuperscript{88} However, ASIC will publish

\textsuperscript{77} Corporations Act 2001 (Cth) Section 1317M.

\textsuperscript{78} ibid., Sections 1317P and 1317Q.


\textsuperscript{80} Australian Securities and Investments Commission Act 2001 (Cth) Section 12GG.

\textsuperscript{81} Corporations Act 2001 (Cth) Section 1317DAC; ASIC, ‘Regulatory Guide 73: Continuous disclosure obligations: Infringement notices’ (October 2017), Paragraphs 1, 3 and 21.

\textsuperscript{82} ASIC, ‘Regulatory Guide 73: Continuous disclosure obligations: Infringement notices’ (October 2017), Paragraph 23(e).

\textsuperscript{83} Corporations Act 2001 (Cth) Sections 1317DAM and 1317DAN, introduced on 13 March 2019 by the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 (Cth).

\textsuperscript{84} ASIC, ‘Regulatory Guide 73: Continuous disclosure obligations: Infringement notices’ (October 2017), Paragraph 6.

\textsuperscript{85} ibid., Table 1 and Paragraphs 13–20; Corporations Act 2001 (Cth) Section 1317DAD(1)(b).

\textsuperscript{86} Corporations Act 2001 (Cth), Part 9.4AB including Section 1317DAT(1).

\textsuperscript{87} Corporations Act 2001 (Cth) Sections 1317DAF(5) and 1317DAU.

\textsuperscript{88} ibid., Sections 1317DAF(4) and 1317DAU(1)(e).
details of the notice and the entity’s compliance. If the entity does not comply with the infringement notice, this fact will not ordinarily be published by ASIC. However, if ASIC commences proceedings against an entity following withdrawal of, or failure to comply with, a notice, ASIC will issue a media release on the fact of commencement and details of the outcome of the proceedings.

In addition to the infringement notices described above:

a. ASIC may issue an infringement notice if it believes on reasonable grounds that a person has breached certain consumer protection provisions in the ASIC Act or the National Consumer Credit Protection Act; and

b. the Panel may issue an infringement notice to a market participant if it has reasonable grounds to believe that the market participant has breached the market integrity rules.

iii Settlements

Civil penalty proceedings brought by ASIC are in some instances settled out of court, with the parties subsequently approaching the court with an agreed statement of facts and ‘agreed penalty’, to request the penalty be converted into an order. In such instances, the court will generally accept a penalty that was within a ‘permissible range’ even if the court would have arrived at a different figure. While this practice has attracted judicial criticism, a series of judgments from the High Court have now confirmed that in civil penalty proceedings a court is not precluded from receiving and, if appropriate, accepting an agreed (or other) civil penalty submission. The High Court has observed that there is an important public policy involved in promoting predictability of outcomes in civil penalty proceedings and that ‘the practice of receiving and, if appropriate, accepting agreed penalty submissions increases the predictability of outcome for regulators and respondents’.

However, recent case law demonstrates that courts will not always approve agreed settlements. In a widely reported 2018 decision, the Federal Court refused to approve a A$35 million settlement agreed between ASIC and a major Australian bank, in relation to breaches

89 ibid., Section 1317DAJ; ASIC, ‘Regulatory Guide 73: Continuous disclosure obligations: Infringement notices’ (October 2017), Table 1 and Paragraphs 39–40.
90 ASIC, ‘Regulatory Guide 73: Continuous disclosure obligations: infringement notices’ (October 2017), Paragraph 41.
91 ASIC, ‘Information Sheet 151: ASIC’s approach to enforcement’ (September 2013), Page 7; Australian Securities and Investments Commission Act 2001 (Cth), Sections 12GX(1) and 12GXA; National Consumer Credit Protection Act 2009 (Cth), Sections 288J and 288K.
92 ASIC, ‘Information Sheet 151: ASIC’s approach to enforcement’ (September 2013), Page 7; ASIC, ‘Regulatory Guide 216: Markets Disciplinary Panel (August 2019), Paragraph 21; Corporations Act 2001 (Cth), Section 798K(1); Corporations Regulations 2001 (Cth), Regulation 7.2A.04.
95 Commonwealth v. Director, Fair Work Building Industry Inspectorate (2015) 258 CLR 482 at [1] (per French CJ, Kiefel, Bell, Nettle and Gordon JJ). This is in contrast to criminal proceedings, in which prosecutors cannot make a submission as to the appropriate sentence or sentencing range: Barbaro v. The Queen (2014) 253 CLR 58.
of Australia’s responsible lending laws. The Court’s key reason for declining to approve the agreement was that the parties did not agree on how or how many times the bank had contravened the National Consumer Credit Protection Act 2009 (Cth), which meant that the Court was unable to assess the reasonableness of the settlement.97

In criminal prosecutions, charge negotiation can take place at any stage.98 This may result in the defendant ultimately pleading guilty to fewer or lesser charges.99 However, criminal prosecutors are not permitted to make submissions to the sentencing judge on the specific sentencing result or the range within which it should fall.100

Following an investigation, ASIC may also be open to negotiating an enforceable undertaking, a form of administrative settlement that ASIC accepts as an alternative to civil or other administrative action.101 ASIC’s willingness to accept enforceable undertakings has reduced considerably since it adopted a ‘why not litigate?’ approach to enforcement in October 2018 in the wake of the Financial Services Royal Commission.102

An enforceable undertaking is a very flexible enforcement outcome and may include:

- details of the misconduct;
- details of how the promisor will address the misconduct, such as through the implementation of monitoring and reporting mechanisms; and
- details of any agreed compensation to third parties or agreement to perform community services, such as funding an education programme.103

ASIC will require that the terms of the enforceable undertaking are publicised.104 Separately, ASIC has noted that it will generally not accept an undertaking that does not acknowledge that ASIC’s views in relation to the alleged misconduct are reasonably held, nor any undertaking containing clauses denying liability or omitting details of the alleged misconduct.105 As a general rule, ASIC will issue a media release regarding the enforceable undertaking and make it publicly available.106 In relation to reports drafted by independent experts, it will publish a summary of the final report or a statement referring to its content (and will generally also publish a summary of, or statement referring to the content of, any interim report).107

ASIC has stated that it will only accept an enforceable undertaking if it considers that it

100 Barbaro v. The Queen (2014) 253 CLR 58.
102 See for example ASIC Commissioner Sean Hughes, ‘ASIC’s approach to enforcement after the Royal Commission’ (speech delivered at the 36th Annual Conference of the Banking and Financial Services Law Association, Gold Coast, Queensland, August 2019). By way of illustration, in ASIC’s report on enforcement outcomes for January to June 2018 (REP 585), ASIC stated that it had obtained 12 enforceable undertakings in that period (Page 5). In the equivalent report for January to June 2019 (REP 625) ASIC stated that it had obtained 1 enforceable undertaking (Page 5).
103 ASIC, ‘Regulatory Guide 100: Enforceable undertakings’ (February 2015), Table 4.
104 ibid., Paragraphs 43–44.
106 ibid., Paragraph 42.
107 ibid., Paragraphs 78–85.
provides a ‘more effective regulatory outcome than non-negotiated, administrative or civil sanctions’.\textsuperscript{108} Importantly, ASIC will not consider an enforceable undertaking unless it has reason to believe there has been a breach of the law and it has commenced an investigation or surveillance in relation to the conduct,\textsuperscript{109} and will not accept an enforceable undertaking as an alternative to commencing criminal proceedings.\textsuperscript{110}

iv  Sentencing and liability

**Criminal proceedings**

The criminal penalties for securities laws contraventions imposed by courts are increasingly severe,\textsuperscript{111} reflecting the gravity with which the courts regard such offences.

For individuals, conviction of certain serious securities market offences carries a sentence of up to 15 years’ imprisonment; a fine that is the greater of (1) A$945,000 (4,500 penalty units) and (2) three times the total value of the benefits obtained and detriments avoided that are reasonably attributable to the commission of the offence; or both imprisonment and a fine.\textsuperscript{112}

 Corporations that commit such offences can be fined the greater of:
\begin{itemize}
  \item[a] A$9.45 million (45,000 penalty units);
  \item[b] three times the total value of the benefits obtained and detriments avoided that are reasonably attributable to the commission of the offence; and
  \item[c] 10 per cent of the corporation’s annual turnover during the year preceding the commission of the offence.\textsuperscript{113}
\end{itemize}

**Civil penalty proceedings**

In civil penalty cases, for individuals, the court may impose a pecuniary penalty of up to the greater of:
\begin{itemize}
  \item[a] A$1.05 million (5,000 penalty units); and
  \item[b] three times the total value of the benefits obtained and detriments avoided that are reasonably attributable to the contravention.\textsuperscript{114}
\end{itemize}

For corporations, the court may impose a pecuniary penalty of up to the greatest of:
\begin{itemize}
  \item[a] A$10.5 million (50,000 penalty units);
  \item[b] three times the total value of the benefits obtained and detriments avoided that are reasonably attributable to the contravention; and
\end{itemize}

\textsuperscript{108} ibid., Paragraph 18.
\textsuperscript{109} ibid., Paragraph 17.
\textsuperscript{110} ibid., Paragraph 21.
\textsuperscript{111} See, for example: \textit{Xiao v. Regina} [2018] NSWCCA 4 (where the Court of Criminal Appeal quashed the sentence imposed by the trial judge in \textit{Regina v. Xiao} [2016] NSWSC 240 but did not accept that the original sentence was manifestly excessive and nevertheless imposed a lengthy effective overall sentence of seven years’ imprisonment with a non-parole period of four years and six months); \textit{Regina v. Glynatis} (2013) 230 A Crim R 99; \textit{The Queen v. Jacobson} [2014] VSC 592; \textit{Commonwealth Director of Public Prosecutions v. Hill and Kamay} [2015] VSC 86.
\textsuperscript{112} Corporations Act 2001 (Cth) Section 1311B, 1311D and Schedule 3 – Penalties. The value of one penalty unit has been A$210 since 1 July 2017. On 1 July 2020 it will be indexed in accordance with Section 4AA of the Crimes Act 1914 (Cth).
\textsuperscript{113} ibid., Sections 1311C and 1311D.
\textsuperscript{114} ibid., Section 1317G(3) and 1317GAD.
c 10 per cent of the corporation’s annual turnover in the year preceding the contravention, up to a maximum of A$525 million (2.5 million penalty units).\textsuperscript{115}

**Infringement notices**

The maximum penalty payable under an infringement notice issued in relation to continuous disclosure is A$100,000 for entities with a market capitalisation over A$1 billion.\textsuperscript{116} For infringement notices under the expanded regime introduced in March 2019, the maximum penalty under the notice is:

\begin{enumerate}
\item (for a criminal offence) half the maximum penalty that a court could impose for the offence; and
\item (for a contravention of a civil penalty provision) A$2,520 (12 penalty units) for an individual and A$12,600 (60 penalty units) for a corporation.\textsuperscript{117}
\end{enumerate}

**IV CROSS-BORDER ISSUES**

i **Jurisdictional issues**

The amenability of a foreign issuer to public or private securities actions in Australia will depend largely on:

\begin{enumerate}
\item the foreign issuer’s legal presence in Australia;
\item whether the foreign issuer is listed on an Australian exchange and the type of listing it has; and
\item the nature and location of the foreign issuer’s relevant conduct that may form the basis of potential securities actions.
\end{enumerate}

**Legal presence in Australia**

One aspect of Australian courts’ jurisdiction is the amenability of a defendant to the court’s writ.\textsuperscript{118} Once a defendant has been legally served, a court has jurisdiction to entertain the action against that defendant.\textsuperscript{119} Service can be effected on those present within the relevant Commonwealth, state or territory jurisdiction. A foreign issuer’s presence in the jurisdiction, and thus amenability to a court’s writ, may be necessitated by either of the following:

\begin{enumerate}
\item a foreign company carrying on business in Australia is required to register with ASIC and appoint a local agent\textsuperscript{120} who, among other things, must accept service on behalf of that foreign company; or
\end{enumerate}

\textsuperscript{115} ibid., Sections 1317G(4) and 1317GAD.
\textsuperscript{116} ibid., Section 1317DAE(2) and (6)(a).
\textsuperscript{117} ibid., Section 1317DAP(1)(f) and (2).
\textsuperscript{118} Lipohar v. The Queen (1999) 200 CLR 485, 516–517 (per Gaudron, Gummow and Hayne JJ).
\textsuperscript{119} Copping v. Tobin Brothers Canberra Marine Centre Pty Ltd [1980] 1 NSWLR 183; Laurie v. Carroll (1958) 98 CLR 310. See also, for example: the Uniform Civil Procedure Rules 2005 (NSW) Rule 6.2; Supreme Court (General Civil Procedure) Rules 2015 (Vic) Rule 6.02; Federal Court Rules 1979 (Cth) Rule 7.1.
\textsuperscript{120} Corporations Act 2001 (Cth) Section 601CF.
\textsuperscript{121} ibid., Section 601CX.
Listing on an Australian exchange

Listing on an Australian exchange creates certain disclosure obligations on a foreign issuer, although these will differ depending on the nature of that listing.

The listing rules regarding continuous disclosure, the foundation of shareholder class actions and ASIC enforcement relating to market disclosure, apply to foreign entities who have a standard ASX Listing and to those who have an ASX Debt Listing in relation to their debt securities.123

Those issuers with an ASX Foreign Exempt Listing, while only required to comply with the disclosure obligations of their home exchange, are nonetheless required to provide the ASX with any information that they provide to their home exchange.124 The provision of such information will still be subject to statutory prohibitions on engaging in misleading conduct.125

Location of relevant conduct

Another aspect of Australian courts’ jurisdiction relevant to foreign issuers is the power of a court to determine a matter,126 which becomes complex where conduct in that matter occurs outside Australia.

Although the provisions in the Corporations Act typically relied on in shareholder class actions do not operate in relation to extraterritorial conduct, there are other statutory prohibitions on engaging in misleading conduct that do.127 Ministerial consent is required to rely on evidence of foreign conduct in any private action claiming damages pursuant to the consumer protection provisions of the ASIC Act, and the Treasury has published guidance to assist in this process.128 However, such consent is generally no longer required by private individuals relying on evidence of foreign conduct to bring an action pursuant to the Australian Consumer Law.129

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122 ASX, Listing Rules (1 December 2019), Rule 1.1 conditions 4 and 5(b) (ASX listings), Rule 1.11 condition 7 (ASX foreign exempt listings), Rule 1.8 conditions 7 and 8(d) (ASX debt listings); ASX, ASX Listing Rules Guidance Note 4 – Foreign entities listing on ASX (1 December 2019), p. 24.

123 ASX, Listing Rules (1 December 2019), Rule 1.10.1; ASX, Listing Rules (1 December 2019), Rules 3.1–3.1B; ASX, ASX Listing Rules Guidance Note 8 – Continuous Disclosure: Listing Rules 3.1–3.1B (23 August 2019).

124 ASX, ASX Listing Rules (1 December 2019), Rules 1.15.2, 1.15.3; ASX, ASX Listing Rules Guidance Note 8 – Continuous Disclosure: Listing Rules 3.1–3.1B (23 August 2019).

125 Such as the Corporations Act 2001 (Cth) Section 1041H and the Australian Securities and Investments Commission Act 2001 (Cth) Section 12DA.


127 Under the Competition and Consumer Act 2010 (Cth) or the Australian Securities and Investments Commission Act 2001 (Cth).


129 Competition and Consumer Act 2010 (Cth) Section 5.
ii Insider trading

Australia’s insider trading provisions have extraterritorial effect. They apply to:

a conduct within Australia in relation to financial products regardless of where the issuer of the product is formed, resides or is located, or of where the issuer carries on business; and

b conduct outside Australia in relation to financial products issued by a person who carries on business in Australia or a company that is formed in Australia.  

iii Cross-border investigations

ASIC continues to cultivate its relationships with overseas regulators to facilitate investigations and enforcement action. The challenge of globalisation was recognised by ASIC in its 2016–2017 to 2019–2020 Corporate Plan as presenting a number of ‘key risks’ that may compromise investor outcomes. The Corporate Plan notes that ASIC will ‘support cross-border activities’, including by:

a facilitating the development and application of consistent standards and requirements across borders, by contributing to the work of international regulatory bodies, principally the International Organization of Securities Commissions;

b supporting equivalence assessments with counterpart regulators;

c negotiating and implementing bilateral and multilateral agreements and understandings, including fintech-related agreements; and

d supporting initiatives that help the capabilities of regulators in our region.

ASIC’s most recent Corporate Plan for 2019–2023 notes that it will facilitate cross-border financial activities and capital flows by:

a engaging and collaborating with international regulators and consolidating key relationships;

b contributing to the work of international bodies;

c designing and implementing regulatory policies relating to the Asia Region Funds Passport and corporate collective investment vehicles;

d implementing a licensing regime for foreign financial services providers;

e negotiating and implementing bilateral and multilateral agreements and understandings on regulatory, supervisory and enforcement matters; and

f exchanging enforcement information under IOSCO’s multilateral memorandum, to mitigate poor behaviour and protect investors.

The 2019–2023 Corporate Plan also notes ASIC’s intention to address potential harms arising from cross-border misconduct or unlicensed activities, fundraising and control transactions involving cross-border transactions, foreign issuers participating in the domestic market, and operational complexities of entities operating within multiple jurisdictions and licensing regimes.

130 Corporations Act 2001 (Cth) Section 1042B.


V YEAR IN REVIEW

i Common fund orders not permitted under s 33ZF of the Federal Court of Australia Act 1976 (Cth)

On 4 December 2019, the High Court of Australia handed down its decision in BMW Australia Ltd v Brewster & Anor and Westpac Banking Corporation & Anor v Lenthall & Ors [2019] HCA 45 (BMW v Brewster), delivering its views on whether section 33ZF of the Federal Court of Australia Act 1976 (Cth) confers the power to make common fund orders.

A common fund order is an order of the court requiring all group members to contribute to the litigation funder’s fee, irrespective of whether group members have signed a funding agreement. In BMW v Brewster, the defendant’s opposition to the plaintiff’s application for a common fund order ultimately resulted in the issue of the court’s power to make a common fund order being referred to the High Court. Section 33ZF of the Federal Court of Australia Act 1976 (Cth) and its equivalent Section 183 of the Civil Procedure Act 2005 (NSW) permit the Court to ‘make any order the Court thinks appropriate or necessary to ensure that justice is done in the proceeding’. The High Court held, by a 5:2 majority, that the courts do not have the power to make common fund orders under these provisions.

The judgment of Kiefel CJ, Bell and Keane JJ interpreted the section as addressing how an action proceeds, rather than the distinct question of whether a proceeding can proceed.133 Their Honours considered that making sure that a proceeding is funded is not ‘appropriate or necessary to ensure that justice is done’ and further considered that to use Section 33ZF to support a common fund order was to effectively ‘re-write’ other legislative provisions that expressly dealt with the distribution of proceeds at the conclusion of those representative proceedings.134 Their Honours held that there was no justification for judicial involvement with common fund orders ‘to ease the commercial anxieties of litigation funders’.135 Various judges acknowledged the problem of free riding in instances where only funded group members bear the costs of the proceedings and turned their minds to whether funding equalisation orders could play a role in addressing equitable cost sharing between group members. Four judges accepted the validity of funding equalisation orders, which provide for deductions from the amounts payable to unfunded group members, that correspond to the funding commission contributions paid by funded group members.136

The decision has widespread implications, particularly for litigation funders who are likely to apply greater scrutiny when assessing the viability of potential class actions going forward. The need for ‘book-building’ before filing a claim will also become more imperative. Discrepancies between costs borne by funded and unfunded group members will continue to be met by funding equalisation orders. Pressure is expected to mount on state and federal legislatures to introduce an express statutory power for courts to make common fund orders.

ii Increased enforcement activity and expanded penalties laws

In 2019 there was a detectable shift in regulatory focus following the conclusion of the Financial Services Royal Commission, which recommended that ASIC’s approach to enforcement should first ask whether a court should determine the consequences of a contravention. The

133 At [47] per Kiefel CJ, Bell and Keane JJ.
134 At [68]-[70] per Kiefel CJ, Bell and Keane JJ.
135 At [94] per Kiefel CJ, Bell and Keane JJ.
136 At [89]-[90] per Kiefel CJ, Bell and Keane JJ; at [169] per Gordon J.
recommendation has sparked ASIC’s new ‘why not litigate’ posture to enforcement, and an uptick in ASIC enforcement investigations. Since the Financial Services Royal Commission, there has been a 20 per cent increase in the number of ASIC enforcement investigations, a 51 per cent increase in enforcement investigations involving the big six banks, and a 216 per cent increase in wealth management investigations.137

Increasingly aggressive enforcement activity was combined with amendments to maximum civil penalties laws. In October 2018, the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 (Cth) was introduced to Parliament. The Bill passed both Houses of Parliament on 18 February 2019, received royal assent on 12 March 2019 and has commenced operation. The Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 (Cth) provides for:

a increased maximum criminal and civil penalties for certain offences and contraventions of civil penalty provisions under the Corporations Act 2001 (Cth), National Consumer Credit Protection Act 2009 (Cth), Insurance Contracts Act 1984 (Cth) and National Credit Code by bodies corporate and individuals;

b an extension of the civil penalty regime to apply to provisions that were not previously civil penalties provisions, including Section 912A (which imposes a duty on financial services licensees to provide financial services efficiently, honestly and fairly) and Section 912D (which imposes a duty on financial services licensees to report breaches or likely breaches of Sections 912A and 912B) of the Corporations Act 2001 (Cth);

c an increased range of circumstances in which an infringement notice may be issued; and

d a lower threshold for establishing ‘dishonesty’ in relation to dishonesty offences under the Corporations Act 2001 (Cth) by removing the subjective limb of the test.

Further, the amending legalisation introduces a provision to deal with the consequences of continuing contraventions of civil penalty provisions. Section 1317QA of the Corporations Act 2001 (Cth) prescribes that where an act or thing is required to be done under a civil penalty provision within a certain period or before a specified time, a person who contravenes the provision commits a separate contravention of that provision in respect of each day during which the contravention occurs. In combination with the increase in the maximum civil penalty for which a contravener may be liable, ASIC is equipped to prosecute claims for civil penalties of a substantial magnitude, which may significantly increase the gravity of proceedings relating to ‘administrative contraventions’ such as breach reporting under Section 912D. ASIC’s Deputy Chair, Daniel Crennan QC, indicated that changes introduced by the Treasury Laws Amendment Act 2019 will result in ASIC seeking harsher civil penalties against banks, executives and others who breach corporate and financial services law.138

The increase in civil penalties powers has coincided with decisions in 2019 imposing record civil penalties. On 20 December 2019, the Federal Court ordered Volkswagen AG to pay A$125 million in penalties, after declaring by consent that it breached the Australian Consumer Law by making false representations in relation to compliance with Australian diesel emissions standards. The figure represents a marked increase on the A$75 million

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138 Ibid.
settlement figure reached by Volkswagen and the Australian Competition and Consumer Commission, criticised by Foster J as ‘manifestly inadequate’. His Honour noted that the penalty agreed by the parties was not supported by any reasoning or justification other than that it was arrived at as a compromise as part of an overall settlement. Although imposed under the old penalty regime, the decision constitutes the highest total penalty order ever made by the Court, and emphasised that parties’ compromise positions will not guide the court’s attitude to what penalty should be payable.

Australian Competition and Consumer Commission v Cornerstone Investment Aust Pty Ltd (in liq) (No 5) [2019] FCA 1544 (Empower Institute Case) also provided an indication that courts may be increasingly willing to impose significant civil penalties in regulatory proceedings. On 20 September 2019, Gleeson J ordered Cornerstone Investments Aust Pty Ltd, trading as Empower Institute, to pay A$26.5 million for contraventions of Sections 21, 29(1)(g), 29(1)(i), 74, 75, 76, 78 and 79 of the Australian Consumer Law. In the Empower Institute Case, Gleeson J found that Empower’s untrained recruiters targeted vulnerable consumers to induce them to sign up to its courses with promises of cash and free laptops, enrolling 6,000 new students in its courses between March 2014 and October 2015, and receiving over A$64 million in VET FEE-HELP payments from the federal government.

These cases illustrate the Federal Court’s increasing preparedness to issue significant civil penalties – a trend that will be closely observed by practitioners in the area of securities litigation. The judicial approach to fixing the amount of a penalty relies on instinctive synthesis, balancing all the factors relevant to the contravention and contravenor, and making a value judgment as to the appropriate penalty given the protective and deterrent purposes of imposing pecuniary penalties. The 2019 expansion of the civil penalty regime, combined with the wide judicial discretion offered by the instinctive synthesis approach, offers greater scope for an expansion of the trend as cases come to be considered under the new penalties legislation.

VI OUTLOOK AND CONCLUSIONS

Securities litigation, both public and private, continues to be a significant risk facing both issuers and financial market participants. The year ahead holds particular uncertainty given the ongoing impact of COVID-19 on markets, industry and regulators.

i ASIC’s regulatory response to covid-19

On 23 March 2020, ASIC announced that it will recalibrate its regulatory priorities and ‘focus its regulatory efforts on challenges created by the covid-19 pandemic’. Specifically, it will:

140 Ibid.
142 ASIC, ‘ASIC recalibrates its regulatory priorities to focus on COVID-19 challenges’ (23 March 2020).

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until at least September 2020, afford priority to matters where there is a risk of significant consumer harm, serious breaches of the law, risks to integrity and time-critical matters;

b where warranted, provide relief or waivers from regulatory requirements, including requirements on listed companies associated with secondary capital raisings and audits;

c suspend a number of near-term activities that are not time-critical, including consultation, regulatory reports and reviews; and

d suspend on-site supervisory work.

The stated purpose of these measures is to enable industry participants to focus on their immediate priorities and the needs of their customers. In practical terms, it could mean that ASIC will temper its ‘why not litigate’ approach to enforcement, which was adopted following the Financial Services Royal Commission.

ii Covid-19 and continuous disclosure obligations

Covid-19 will present significant challenges to listed entities in relation to complying with their continuous disclosure obligations. Rapidly changing circumstances in relation to reduced consumer demand, supply chain disruptions, increased credit risk and counterparty risk, market volatility, and the impact of government interventions will make it more difficult than usual for companies to quickly identify and release information that is likely to have a material effect on the price or value of their securities. This could result in increased regulatory and class-action risk for some companies.

iii Introduction of contingency fee arrangements in Victoria

The Victoria State Government has indicated that it intends to make amendments to the Supreme Court Act 1986 (Vic) which would make it legal for plaintiff lawyers to charge clients a percentage of a settlement or court order following a successful claim. This move would bring the rules related to plaintiff law firms in line with those regulating litigation funders, who are already able to charge contingency fees.

The amending bill was introduced in response to recommendations made by the Victorian Law Reform Commission (VLRC) in March 2018. The VLRC considered that the availability of contingency fees could improve access to justice, introduce competition for litigation funders and be appropriately controlled under the Court’s supervision.143

The bill empowers the Supreme Court of Victoria to make contingency fee arrangements (referred to as group costs orders) on the application of the representative plaintiff, where the Court is satisfied that it is appropriate or necessary to ensure justice in the proceeding. The bill envisions the sharing of the contingency fee among the plaintiff and all group members. A group costs order would also make the plaintiff law firm liable to pay costs awarded to the defendant and give security for costs ordered.

The reform may result in forum shopping and a rise in the number of class actions brought in Victoria, as contingency fees continue to be prohibited in the Federal Court and in other state courts. Greater competition over high-value claims, including securities class actions, is another likely consequence, and may in turn drive down commissions to the

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benefit of class members. Whether some plaintiff law firms will respond with greater efforts to reduce the costs of running the trial remains to be seen. On a broader level, other state parliaments will be closely observing the Victorian experience to inform their own approaches to contingency fee arrangements.

As of 19 March 2020, the bill continues to be debated in the Victorian Legislative Council.
I OVERVIEW

i Sources of law

The basic foundations of the Brazilian securities market are set out in:

a Law No. 6,385/1976, which set up the pillars of the Brazilian securities market and created the Securities Commission\(^2\) (CVM);
b Law No. 6,404/1976, which regulated the joint-stock companies, their management and several types of securities related to capital funding; and
c Law No. 4,595/1964, which created the National Monetary Council\(^3\) (CMN) to govern the financial sector.

In addition to federal legislation, there is a robust body of rules issued by the CVM covering a wide range of matters related to securities and listed companies, such as initial public offerings, issuance of bonds, issuance of Brazilian depositary receipts, and disclosure and control of inside information, among others.

There are also rules issued by specific self-regulatory private companies with authority to regulate the conduct of players and trades in securities within their own markets, pursuant to Rule No. 461/2007 of the CVM. Among these private companies is B3 SA (Brasil, Bolsa, Balcão) (B3), Brazil’s most important stock exchange and over-the-counter market.

ii Regulatory authorities

Offences under Brazilian securities laws may translate into one or more of administrative, civil and criminal liabilities. The offenders may be prosecuted in all these three spheres separately, before different courts and regulatory authorities, and face different sanctions in relation to a same offence.

At the forefront of the administration is the CMN, the purpose of which is to set general guidelines to be followed by the financial system, including Brazil’s Central Bank and the CVM, as well as by the securities market as a whole.

The CVM acts as a regulatory agency and plays the role of the backbone of the securities market, regulating it and implementing the guidelines and policies set by the CMN. The
CVM is managed by a board composed of a chairman and four commissioners, who are nominated by the President of Brazil and approved by the Senate. Several technical bodies with specific attributions also work under the direction of the CVM’s board.4

The CVM has the authority to regulate and issue rules applicable to all listed companies, investment funds, stock exchanges, over-the-counter markets, entities of the securities distribution system and investors.5 The CVM also works directly with players in the capital markets, overseeing their activities, approving the registration of listed companies and the issuance of bonds, among other activities.

The CVM acts in the administrative enforcement sphere as the main authority responsible for overseeing Brazil’s capital markets as a whole. Matters revolving around insider trading, misinformation and fraud, among others, may be investigated directly by the CVM through commencement of administrative proceedings that may eventually lead to severe sanctions, such as multimillion-reais penalties and temporary suspension of the right to take positions within Brazil’s capital markets. The administrative decisions issued by the CVM may be appealed at the board of appeals of the National Financial System.6

On the judicial front, disputes involving securities are generally of a civil nature, usually claimed in state courts directly by aggrieved private entities. Should an offence to securities legislation cause collective losses to holders of securities, the Public Prosecutor’s Office may seek redress on their behalf, as it has standing to file class actions in such scenarios.7 Such redress may occur on the initiative of the Public Prosecutor’s Office or at the request of the CVM, which can join such claims as co-plaintiff, assistant or even as amicus curiae, rendering its opinion or clarifications on the matters under scrutiny. The CVM may also file appeals against court decisions, should the parties fail to do so.8

In the private sector, self-regulatory entities such as stock exchanges and over-the-counter markets also have mechanisms for the compensation of damage. Special emphasis is given on BM&FBOVESPA Supervisão de Mercados (BSM), founded by B3 with the sole purpose of overseeing activities carried out within its own markets.

### iii Common securities claims

Securities litigation in Brazil involves all types of securities, such as shares (of companies and funds), debentures, warrants, commercial paper, derivatives, etc., and are mostly related to disputes over corporate governance, intermediation and auditing liabilities, conflicts of interest, disclosures, frauds or omissions, minority shareholders’ rights, creditors’ rights, bankruptcy and reorganisation related to distressed companies, and compliance with regulations of the CVM, stock exchange and over-the-counter markets.

There are four main avenues for dispute resolution in Brazil:

- a) court litigation;
- b) arbitration;
- c) conciliation; and
- d) mediation.

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4 Decree No. 6,382/2008, Section IV of attachment I.
5 Decree No. 6,382/2008, Article 8 of attachment I.
6 Conselho de Recursos do Sistema Financeiro Nacional.
8 Law No. 6,385/1976, Article 31.
Most cases are referred to court or arbitration, depending on the disputed amount or the relevance of matters under scrutiny. Securities litigation in Brazil is not so common when compared with foreign markets or even to other sectors in Brazil.

In recent years, most high-profile cases have been tried before arbitration panels under secrecy, partially because of the B3 rules demanding the inclusion of arbitration clauses in companies’ by-laws for their admittance at the highest corporate governance segments. The use of arbitration is one of the reasons for the lack of relevant court precedents related to securities litigation. Consequently, the precedents normally used as guidance for Brazilian market players mostly derive from the CVM and frequently deal with insider trading, breach of fiduciary duties, market manipulation and abuse of voting rights.

Secondary liability of financial and legal advisers is not presumed under Brazilian law; it must necessarily rely on evidence of wilful misconduct or the pursuit of joint benefits by those advisers and their clients.

On the other hand, the CVM and Public Prosecutor’s Office may bring claims against advisers – most frequently against auditors – for negligence or breach of duty. Civil liability for negligence and ensuing damage caused by auditors to third parties is specifically provided in Law No. 6,385/1976.

II PRIVATE ENFORCEMENT

i Forms of action

There are two main categories of civil liability in Brazil:

a Fault-based liability, based on the culpability theory, in which there must be damage, the occurrence of a faulty action, omission or wilful misconduct, and causation between the action or omission and the damage suffered by the party.

b Strict liability, based on the risk theory, which applies irrespective of fault, and evidence will solely relate to the link of causation between an action or omission and the damage allegedly suffered by the party (i.e., fault, negligence and wilful misconduct are irrelevant for the purposes of establishing the duty to indemnify).

While fault-based liability is the general rule, strict liability applies to cases specified in the law (e.g., consumer rights under Law No. 8,078/1990) or when the offender’s activity, by its nature, implies inherent risks for third parties (e.g., a carrier of hazardous or flammable substances).9

Under Brazilian law, only direct damage is subject to indemnification. Any indirect damage is not indemnifiable, as only the party directly affected would have standing to sue.10 For instance, court precedents usually hold that the mere devaluation of shares or decrease in dividends arising out of fraudulent conduct of the senior managers causes only indirect damage to shareholders, as the directly harmed party would be the company itself. Therefore, the company would be the entity with standing to claim such losses. On the other hand, common examples of direct damage caused to shareholders may be the wilful undervaluation of shares for purposes of mergers and violations to right of first refusal in capital increases, as such actions directly affect shareholders’ rights.

10 Law No. 13,105/2015, Article 18.
Securities disputes usually relate to:

- corporate governance, conflicts of interest, manager misconduct and shareholders’ rights within listed companies; and
- damage caused by default of obligations in securities transactions.

In either case, disputes generally revolve around civil liability and the duty to indemnify, which should be limited to the losses directly and reasonably evidenced by the aggrieved party under the Brazilian Civil Code.\(^\text{11}\)

Disputes involving corporate governance usually deal with wrongful or unlawful acts and breaches of statutory and corporate rules by the senior managers and causing damage at different levels, namely to the company, its shareholders and third parties. This wrongdoing may give rise to the filing of \textit{ut universi} lawsuits, \textit{ut singuli} lawsuits and ordinary civil liability lawsuits.

The shareholders or third parties that suffered a direct, particular loss from senior managers’ misconduct may file an ordinary, individual liability lawsuit to recover the loss, according to Law No. 6,074/1976, Article 159, Paragraph 7. In such cases, the losses are suffered directly, specifically and personally by the shareholders or third parties concerned, being unrelated to the company’s interests or to the losses that may have been concurrently suffered by the company. Losses related to insider trading by senior managers are examples of losses that may directly affect shareholders in their individual capacity.

If losses are suffered by the company directly, the filing of a liability lawsuit (\textit{ut universi}) may be submitted for deliberation at the shareholders’ general meeting. If a majority of the shareholders approve the filing, the senior managers accused of wrongdoing will be immediately dismissed from their positions and the company itself will file the liability lawsuit against them within three months. If the company fails to do so, any shareholder may bring this lawsuit on its behalf,\(^\text{12}\) and any amount recovered by the shareholder will accrue to the company. If the filing is rejected at a general meeting, the liability lawsuit may be filed on behalf of the company by shareholders representing at least 5 per cent of the corporate capital (\textit{ut singuli} lawsuit). In this scenario, however, the accused senior managers will not be automatically dismissed from their positions, as the matter has not been previously approved at the shareholders’ general meeting.

A liability lawsuit may be brought against the controlling shareholders for recovery of damages in cases of abuse of controlling power,\(^\text{13}\) if the controlling shareholder\(^\text{14}\) is responsible for losses of the controlled company. The standing to file this claim lies with:

- the minority shareholders with at least 5 per cent of corporate capital; or
- any shareholder with less than such an amount (in this case, the shareholder must deposit in court an amount equivalent to legal expenses and attorneys’ fees).

\(^{11}\) Law No. 10,406/2002, Article 944.

\(^{12}\) Law No. 6,404/1976, Article 159, Paragraph 3.

\(^{13}\) Law No. 6,404/1976, Article 117, sets forth several duties and standards of conduct attributable to controlling shareholders.

\(^{14}\) Law No. 6,404/1976, Article 116, defines controlling shareholder as the person, legal entity or group of persons or legal entities bound by a shareholders’ agreement that have joint ownership of voting rights that ensure the majority of votes at general meetings and the power to nominate most senior managers, provided that such voting rights are enforced.
The damage from default of obligations in securities transactions may also give rise to indemnity claims, which are generally brought by investors who suffered direct damage because of the wrongdoing. For instance, fraudulent issuance of securities may give rise to civil lawsuits filed by individuals seeking redress of damage.

Finally, a public civil lawsuit (akin to a class action lawsuit) is set forth in Law No. 7,913/1989. It aims to obtain reimbursement for damage caused to a group of securities’ holders. Such an action must be filed directly by the Public Prosecutor’s Office, which may act on its own initiative or upon the request of the CVM. The damages recovered through this lawsuit will revert to the aggrieved investors rateably to their individual loss.

### Procedure

As private securities claims are mostly of a civil nature, the applicable procedure is set out in Law No. 13,105/2015, known as the Code of Civil Procedure, enacted in March 2015 and effective as from 18 March 2016. It is a federal law effective in both federal and state jurisdictions.

Generally, lawsuits discussing offences to securities law are tried in state courts. Exceptionally, the jurisdiction will pass to federal courts should a public entity such as the CVM request to join the proceeding as an interested third-party. Moreover, the Federal Constitution and applicable legislation do not contemplate trial by jury in commercial and civil cases.

As a rule, lawsuits at state and federal courts are tried publicly. The court may order the case to be conducted under secrecy in certain circumstances to preserve the parties’ privacy or in the public interests.

Both plaintiff and defendant have the burden of proving their own claims raised in the complaint and in the defence. Unlike US proceedings, Brazilian legislation does not provide for broad discovery allowing the party to oblige its opponent to disclose a vast amount of documents and information as evidence in the litigation. The Code of Civil Procedure puts at the parties’ disposal a more limited proceeding, in which the plaintiff must satisfy certain legal requirements, such as evidence of the existence of documents and their importance for the matter under scrutiny, to be granted the command obliging the opponent to disclose them in court. Thus, it may be burdensome for investors to file securities lawsuits owing to the limited scope of discovery available in Brazil.

As a general rule, each party has the burden to prove its own claims. The court may innovate by imposing on the other party the burden to produce certain pieces of evidence important for the matter under scrutiny. This inversion may occur, for instance, where:

- the party originally obliged to produce evidence in court cannot do so; or
- one of the parties has more ready access to evidence.

Once discovery is complete, including the holding of trial hearings, the court may render its decision, which is appealable at the respective court of appeals.

Should the parties opt for arbitration, Law No. 9,307/1996 allows parties to customise the proceeding (e.g., by establishing that it will be subject to confidentiality), within certain

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16 Law No. 13,105/2015, Article 189.
17 Law No. 13,105/2015, Article 373, Paragraph 1.
limits prescribed by law, although it is common that the regulations set forth by major Brazilian arbitration chambers will be followed. At the end of the proceeding, the panel will render an arbitration award, which is non-appealable.

A public civil lawsuit tends to result in generic awards confirming or rejecting investors’ rights and affecting the whole group to which it relates. The damages recovered through this public collective lawsuit will ensure to aggrieved investors rateably to their individual loss, as per Law No. 7,913/1989. In generic sentences, the assessment of damage and its further enforcement against the debtor may be burdensome and time-consuming.

iii Settlements
As a general rule, claims related to disposable rights – such as disputes between private parties over securities – can be settled, either in court or out of court. Out-of-court settlements may need to be recognised in court, but this recognition is limited to an analysis of any possible violations of the law, not to the economic provisions of the settlement.

In the case of a liability lawsuit (ut universi), the settlement must be previously approved by the corporate bodies, including by those shareholders that had originally approved the filing of the lawsuit.

In derivative suits (ut singuli), the settlement between shareholders and senior managers would be ineffective, as the right under scrutiny belongs to the company and not to the shareholder acting as plaintiff on its behalf. Only the company can dispose of any of its rights. For such a settlement with a shareholder to be effective, it must be previously submitted and approved by a general shareholders’ meeting. Nonetheless, the shareholder acting as plaintiff may decide to discontinue the derivative suit, since he or she ultimately holds control over the procedure (i.e., in this case, the shareholder would not be settling or waiving any of the company’s rights without prior authorisation, but would only be withdrawing the claim without prejudice, which may be later reclaimed by the company during the corresponding limitation period).

In the case of public civil lawsuits involving securities claims (Law No. 7,913/1989), the Public Prosecutor’s Office cannot settle and dispose of any investors’ rights either, as the right under scrutiny does not belong to it.

iv Damages and remedies
In civil liability lawsuits, indemnification for property and moral damages can be granted by courts. Property damages are tantamount to the actual damage suffered by the aggrieved party. The plaintiff must state the extent of recoverable damages at the filing of the lawsuit. This is meant to prevent plaintiffs from seeking excessive compensation, as the stated amount will serve for calculation of court costs payable by the losing party.

The same rule applies to moral damages (pain and suffering), where the plaintiff will also need to state the full amount of recoverable damages at its statement of claim.

In derivative suits (ut singuli), all damages recovered revert in favour of the company, as the shareholders are acting on its behalf. The same goes for public civil actions, where the Public Prosecutor’s Office litigates on behalf of a group of shareholders and, thus, all damages recovered will accrue to the latter.

18 Law No. 13,105/2015, Article 292.
Remedies granted by Brazilian courts are not limited to monetary obligations. Courts are also allowed, for example, to review the economic aspects of certain agreements or even compel a party to refrain from certain practices.

As for allocation of expenses in litigation, the defeated party bears all expenses, including attorneys’ fees.

III  PUBLIC ENFORCEMENT

i  Forms of action

As the main administrative authority responsible for overseeing the securities market, the CVM investigates, prosecutes and punishes securities laws violations. All market players, such as senior managers, shareholders, investment funds and listed companies, are subject to the CVM’s scrutiny, regardless of their civil or criminal liability.

Though uncommon, securities market misconduct can also be treated as a crime and, as such, investigated by the Public Prosecutor’s Office, with the help and support of the CVM. Notable examples of criminal conduct are market manipulation and the use of inside information.19 The Public Prosecutor’s Office has standing to bring a suit in court regarding criminal offences against the securities market.

The Federal Public Prosecutor’s Office has intensified the crackdown on securities crimes and, within such a context, signed a cooperation agreement with the CVM in 2008 to facilitate the exchange of relevant information and to optimise their oversight of the Brazilian securities market. If the CVM’s investigation reveals the existence of a potential criminal offence, it must notify the Public Prosecutor’s Office, following the procedure established in the Brazilian Criminal Procedure Code.20

ii  Procedure

The CVM’s administrative proceedings are governed by federal laws21 and the CVM’s internal regulations,22 and emulate the principles and rules of criminal procedure.

The general timeline for administrative procedure is the following: on becoming aware of a securities law violation, the CVM asks the relevant party for information. If the information received is unsatisfactory, the CVM prepares an accusation containing key information on the illicit act. The specialist prosecutors’ office will render an opinion, and the accused party will present a formal defence. Then, the case files are remitted to a technical body for a report on the entire proceeding. Finally, the accused party comments on the report and the CVM’s board of commissioners eventually makes a decision. This decision may be appealed at the board of appeals of the National Financial System.

The case files of administrative proceedings are generally open to the public upon receiving a justified request. The decisions issued by the CVM’s board of commissioners are made public on the CVM’s website.

Furthermore, the CVM’s decisions can be challenged in courts via ordinary lawsuits.

19  Law 6,385/1976, Articles 27-C and 27-D.
20  Law No. 3,689/1941.
iii Settlements

The CVM may settle with securities law offenders via a settlement agreement or a plea deal (whistle-blowing agreement). These possibilities have been in place since enactment of Law No. 13,506/2017, which significantly changed Law No. 6,385/1976.

Settlement agreements authorise the CVM to stay administrative proceedings in the public interest, whether during preliminary investigations or in the course of the proceedings, for execution of a settlement agreement by which the accused (or investigated) party agrees to cease the acts or activities deemed illicit by the CVM and correct (and compensate for) any irregularities found. The procedure for execution of a settlement agreement is governed by CVM Resolution No. 390/2001, and entails no acknowledgement of guilt by the signatory; therefore, should the latter default any of his or her obligations under the settlement, the CVM may resume the proceeding and, ultimately, impose sanctions on him or her.

For its part, the plea deal (whistle-blowing agreement) allows the CVM to exonerate the offender from liability or reduce sanctions by one-third to two-thirds as the offender confesses to violating securities laws and undertakes to cooperate with investigations in identifying the other violators, gathering relevant documents, among others. The execution of such an agreement is cumulatively conditioned to:

- the legal entity being the first to qualify among violators related to the same facts;
- the legal entity ceasing its participation in the relevant offence;
- the CVM lacking sufficient evidence to convict the relevant person or legal entity at the time; and
- the person or legal entity fully cooperating with the investigation throughout.

The execution of a settlement agreement in relation to public civil lawsuits, including those concerning securities claims, is permissible under Law No. 7,347/1985. The agreement may be entered into jointly by the CVM and the Public Prosecutor’s Office, leading to an administrative and court settlement covering the same securities offence.

iv Sentencing and liability

Law No. 13,506/2017 was enacted at the end of 2017 in answer to recent scandals of corruption involving major players in the Brazilian securities market. It significantly increased all monetary penalties imputable by the CVM, which may not exceed the greater of: (1) 50 million reais; (2) twice the value of the irregular issuance or transaction; (3) three times the economic advantage obtained or loss avoided by the wrongdoing; or (4) twice the damage that the wrongdoing caused to investors. These fines may be tripled in the event of recidivism.

The CVM may also apply non-monetary penalties, such as suspension, disqualification and prohibition from engaging in certain activities or transactions in the securities market for up to 20 years.

In the criminal sphere, offences against the capital markets may result in custodial sentences. For instance, those liable for market manipulation and insider trading are subject to custodial sentences of up to eight and five years, respectively, plus fines of up to three times the illicit benefit obtained.

23 Law No. 6,385/1976, Article 10, Paragraph 5.
26 Law No. 6,385/1976, Articles 27-C and 27-D.
IV CROSS-BORDER ISSUES

The CVM is in charge of investigating and punishing offences against capital markets, as long as they (1) have caused damage to residents in Brazil, regardless of the actual place where the offences occurred, or (2) occurred within the Brazilian territory.27

In the civil sphere, Brazilian court may assert jurisdiction over: (1) defendants domiciled in Brazil; (2) obligations to be performed in Brazil; and (3) claims deriving from facts or acts that occurred in Brazil.28 Brazilian law does not set any special conditions or requisites for a foreign individual residing in Brazil to bring suit before the Brazilian courts. For their part, foreign-based plaintiffs bringing claims in Brazilian courts must post bond to secure court costs and attorneys’ fees. Shareholders residing abroad must also appoint a legal representative with powers to be served on their behalf over matters related to capital markets, pursuant to Law No. 6,404/1976.

In the criminal sphere, Brazilian courts have jurisdiction over any wrongdoing within national borders and any acts whose effects are verified within the Brazilian territory.29

Therefore, foreign issuers falling under the aforesaid conditions are subject to oversight of the CVM or Brazilian courts, or both.

V YEAR IN REVIEW

The year 2019 saw an increase in warning notes issued by the CVM by which a given player is advised that his or her acts could lead to commencement of administrative proceedings. There were 488 at the end of 2019, compared with 357 during 2018 and 290 during 2017. On the other hand, there were fewer investigative proceedings initiated in 2019 compared with 2018 and 2017 – 102, 105 and 138, respectively, where:
- 79 evolved into accusations;
- 17 are still under administrative investigation; and
- six were tried through simplified procedure.

There were also fewer administrative sanctioning proceedings initiated in 2019 compared with 2018 and 2017 – 97, 104, 126.

In 2019, the CVM ruled on a total of 98 administrative sanctioning proceedings, a slight reduction when compared to the 109 ruled in 2018. As a result, the administrative proceedings ruled by the CVM’s board of commissioners resulted in:
- 226 fines;
- one suspension;
- 18 disqualifications;
- 21 prohibitions; and
- 138 discharges.

The total amount of fines applied in 2019 was 1,040 billion reais (in 2018, the fines had amounted to 350,3 million reais). Moreover, 2019 saw a slightly decrease in administrative

27 Law No. 6,385/1976, Article 9, Paragraph 6.
28 Law No. 13,105/2015, Article 21.
29 Decree-Law No. 2,848/1940, Articles 5 and 6.
proceedings approved for execution of settlement agreements. In total, 48 proceedings were settled with 179 different entities, generating around 66,2 million reais in revenues from settlement agreements.30

The plea deal has proved an instrumental tool for uncovering offences in the capital markets, and its use is likely to increase, as Law No. 13,506/2017 has allowed the CVM to enter into such plea deals directly.

A new regulation for B3’s trading segment demanding the highest levels of corporate governance was approved in the second half of 2017, becoming effective in January 2018. This has brought significant changes to listed companies, such as new rules for disclosure of information and new standards for the number of directors and officers, among others.

VI OUTLOOK AND CONCLUSIONS

In 2019, the government approved the social security reforms and is committed to approving taxation and administrative reforms, which will help to foster economic growth and attractiveness to investors if approved. GDP growth in 2019 was 1,1 per cent. The covid-19 pandemic has caused severe uncertainty in the global market, which will also affect Brazil’s growth forecasts.

The market also awaits new developments in the efforts towards enacting a new Commercial Code31 that could put the 1976 Brazilian Corporation Law on a par with cutting-edge legislation.

The effects of Law No. 13,506/2017 are likely to be felt more intensely in the coming years, giving rise to new plea deals with the CVM. This, coupled with B3’s new regulations for its trading segment demanding the highest level of corporate governance, should help the further maturing of Brazil’s capital markets.

A significant increase in questions involving the fulfilment or enforcement of derivative transactions is expected, owing to the crisis caused by the coronavirus pandemic. Although derivative contracts contain, as a rule, clauses regarding the effects of force majeure, the actual interpretation by Brazilian courts of the effects and extent of such clauses should be scrutinised from now on.

31 Legislative Bill No. 1,572/2011.
Chapter 4

CANADA

Laura Paglia and Matthew J Epp

I OVERVIEW

i Sources of law
Securities laws in each of Canada’s 10 provinces and three territories provide the legal foundation for legal and regulatory requirements related to the capital markets. Multiple sources inform securities laws. ‘Laws’ include and are informed by each provincial Securities Act and any regulations or rules pursuant to those acts blanket rulings, orders and decisions issued by each provincial securities regulator, National Instruments agreed to by the Canadian Securities Administrators (CSA) and decisions of provincial courts.

ii Regulatory authorities
Securities matters are not currently federally regulated in Canada. Each province and territory has its own securities regulator, provincial Securities Act and provincial case law from its own regulator or court. The CSA is an umbrella organisation and informal body comprising Canada’s provincial and territorial securities regulators. Its goal is to achieve consensus on policy decisions and governing principles impacting Canadian capital markets. As a result, securities markets are also governed by National Instruments, promulgated by the CSA, which apply to such matters as the distribution of securities, disclosure obligations, securities transactions (such as mergers, acquisitions and takeover bids) and registration matters.

Enforcement of securities law is achieved in part by provincial securities commissions, which function as specialist administrative tribunals, and in part by provincial courts. The provincial securities commissions have delegated to certain self-regulatory organisations (SROs) the power to regulate the conduct of securities and mutual fund dealers, under the supervision of CSA members. The primary SROs in Canada are the Investment Industry Regulatory Organization of Canada (IIROC), the Chambre de la Sécurité Financière (CSF), the Financial and Consumer Services Commission, the Ontario Securities Commission and the Office of the Superintendent of Securities (Prince Edward Island).

1 Laura Paglia and Matthew J Epp are partners at Borden Ladner Gervais LLP.
2 The Canadian Securities Administrators are the Alberta Securities Commission, the British Columbia Securities Commission, the Manitoba Securities Commission, the Financial and Consumer Services Commission (New Brunswick), the Office of the Superintendent of Securities Service Newfoundland and Labrador, the Office of the Superintendent of Securities (Northwest Territories), the Nova Scotia Securities Commission, the Nunavut Securities Office, the Ontario Securities Commission, the office of the Superintendent of Securities (Prince Edward Island), L’Autorité des Marchés Financiers (Quebec), the Financial and Consumer Affairs Authority of Saskatchewan and the Office of the Yukon Superintendent of Securities.
3 With rights of appeal ultimately to the Supreme Court of Canada.
and the Mutual Fund Dealers Association of Canada (MFDA). IIROC governs investment dealers and performs exchange surveillance. The MFDA governs mutual fund dealers in Canada (other than in Quebec). The CSF governs mutual fund dealers in Quebec. Exchanges monitor compliance by listed companies with their listing agreements, terms and policies. They may deny approval of certain transactions, require corrective action (disclosure), halt or suspend trading, or deny or terminate a listing.

The Integrated Market Enforcement Team (IMET), an investigation unit of the Royal Canadian Mounted Police, may investigate securities-related crimes. Public prosecutors in provincial offices or equivalents may prosecute contravention of securities laws, as well as of criminal laws, before a court. In some provinces, the enforcement staff of a provincial commission may also bring securities law contraventions before a court.

### iii Common securities claims

Regulatory proceedings may vary widely in subject matter. Enforcement statistics from key Canadian regulators are listed in this chapter.

Civil claims from retail investors are often related to the suitability of the investment and to various forms of misrepresentation. They may be brought individually or by class action. Relief by shareholders, officers, directors and other ‘proper persons’ is also at times sought against a corporation by derivative action or the pursuit of an oppression remedy.

### II PRIVATE ENFORCEMENT

#### i Forms of action

Retail investors with a claim not exceeding 350,000 Canadian dollars or more may submit, at no cost, a written complaint to the Ombudsman for Banking Services and Investments (OBSI). The OBSI follows an informal process in accordance with its Terms of Reference to reach a non-binding recommendation for restitution. Quebec’s provincial regulator, the Autorité des Marchés Financiers (AMF), provides a mediation service to all clients of registered dealers and advisers. With the exception of Quebec registrants and investment fund managers, all market registrants are required to participate in the OBSI process. In addition, IIROC and MFDA members also have mandatory requirements with respect to reporting complaints to them and with respect to the handling of such complaints. IIROC members must also submit to binding arbitration for any claims of 500,000 Canadian dollars or less at the investor’s option, although this option is rarely used as, unlike the OBSI, arbitration costs are incurred.

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4 On 12 December 2019, the CSA announced that it would undertake a review of the regulatory framework for IIROC and the MFDA and stated that it expects to publish a consultation paper by mid-2020, re-examining the policy reasons for the current regulatory framework.


6 IIROC Dealer Member Rules (2 January 2018) (IIROC Rules), Rule 2500B (Client Complaint Handling) and Rule 3100B (Reporting Obligations); Rules of the Mutual Fund Dealers Association (4 January 2016) (MFDA Rules), Rule 2.11 (Client Complaint Handling) and Rule 1.4 (Reporting Obligations).

7 IIROC Rules, Rule 37.
ii Procedure
Retail investors can also initiate a claim in the civil court system, as individuals or as part of a class action, to seek damages.

Class proceedings legislation exists in most provinces. The legislation is procedural and provides requirements for such matters as the certification of a class, notice, settlement, legal fees and opt-in or opt-out provisions. The test for certification generally requires that a cause of action is disclosed by an identifiable class of two or more persons that raises common issues, and renders a class action the preferable procedure through the appropriate representative plaintiff.8 Currently, a class action may still be certified if damages require individual assessments, different remedies are sought for different class members or common issues are not shared by all class members.9

iii Settlements
Settlements of class actions are subject to court approval. The test for approval of a settlement of a class proceeding is whether the settlement is fair and reasonable and in the best interests of the class. On a motion for approval of a settlement of a class proceeding, the court must consider whether: (1) there are any indicators of collusion or conflicts of interest in the settlement or the process leading to the settlement that might call into question its fairness; and (2) the compromise embodied by the settlement falls within the range of reasonableness in the particular circumstances of the case.10 In Ontario, the court has found the same test to be applicable under the class proceedings legislation of that province as in Section 138.1 of the Ontario Securities Act, RSO 1990, c. Section 5 (OSA) discussed below.11

Securities class actions – deemed reliance
There are various ‘deemed reliance’ provisions in the OSA that render misrepresentation susceptible to class actions in Ontario. Liability arises with respect to these misrepresentations without regard to whether the purchaser relied on the misrepresentation. Part XXIII of the OSA imposes civil liability for misrepresentation in the primary market. There is liability for misrepresentation in an (amended) prospectus, takeover bid circular, director or officer’s circular, and issuer bid circular.12 A right of action for misrepresentation, without reliance, lies against such individuals as the issuer, underwriters, directors and others who consented to the disclosure or signed the prospectus.13

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8 Class Proceedings Act, 1992, SO 1992, c6, Section 5 (CPA). On 9 December 2019, Ontario’s Attorney General Introduced Bill 161 in the Legislative Assembly as the ‘Smarter and Stronger Justice Act, 2019’ aimed at providing amendments to various statutes to provide ‘better, more affordable justice for families and consumers’. Proposed changes to the CPA are included in Bill 161. Suggested amendments to the CPA include amendments to the certification test to put greater significance on a class proceeding as the ‘preferable procedure’, in turn, including whether a class proceeding is ‘superior’ to all ‘reasonably available means’ to address relief for class member and whether questions of fact or law predominate over questions impacting class members individually.

9 CPA, Section 6.

10 McDonald v. Home Capital Group, 2017 ONSC 5004.

11 CPA, Section 29(2); McDonald v. Home Capital Group, 2017 ONSC 5004.

12 Ontario Securities Act, RSO 1990, c. Section 5 (OSA), Sections 130 (1) and 131(1)–(3).

13 OSA, Section 130(1).
Among the defences available is that of a ‘reasonable investigation’. A reasonable investigation provides reasonable grounds for a belief that there was no misrepresentation. It is in turn subject to a standard of reasonableness required of a prudent person in the circumstances.\textsuperscript{14} Damages recoverable cannot exceed the price at which the securities were offered. For underwriters, damages cannot exceed the total public offering price represented by the portion of the distribution underwritten.\textsuperscript{15}

Part XXIII.I of the OSA imposes civil liability for secondary market disclosure without regard to reliance by the purchaser.\textsuperscript{16} A right of action for misrepresentation, without reliance, lies against the issuer, officers and directors, ‘influential persons’ and experts if the misrepresentation is contained in their opinion and they consented in writing to its reliance.\textsuperscript{17} A right of action also exists for public oral statements\textsuperscript{18} and for failure to make timely disclosure of a material change.\textsuperscript{19} Considerations for the assessment of damages are set out in the OSA.\textsuperscript{20}

Multiple misrepresentations or multiple instances of failure to make timely disclosure of a material change that have a common subject may be treated as a single misrepresentation or failure in the discretion of the court.\textsuperscript{21} Again, among the several defences available is that of a reasonable investigation with the factors for consideration by the court set out in the OSA.\textsuperscript{22}

An action for misrepresentation in the secondary market requires leave of the court, which is granted where the action is brought in good faith and there is a reasonable possibility that the action will be resolved in favour of the plaintiff. The OSA sets out a procedure for affidavit materials, filing and notice requirements.\textsuperscript{23}

A limitation period applies. No action shall be commenced later than the earlier of three years from the date the misrepresentation in the document or public oral statement is made or six months after the issuance of a press release announcing that leave has been granted.\textsuperscript{24}

\textit{Other actions against the corporation}

Pursuant to the Canada Business Corporations Act, RSC 1985, c. C-44 (CBCA) and similar legislation in other provinces, a ‘complainant’, generally defined as a shareholder, officer, director or ‘any other person who, in the discretion of the Court is a proper person’ may bring a derivative action to pursue a claim on behalf of a corporation.\textsuperscript{25} A derivative action requires leave of the court, who must be satisfied that the complainant is acting in good faith and the action is in the interest of the corporation.\textsuperscript{26} A complainant may also seek an oppression
remedy,\textsuperscript{27} which does not require leave and which is a broad remedy that may extend to many types of ‘unfair conduct’. The court will consider whether there is evidence to support the breach of reasonable expectation asserted by the relevant interest of the stakeholder.\textsuperscript{28} Complainants may seek both remedies.

### III PUBLIC ENFORCEMENT

#### i Forms of action

Regulatory enforcement actions are generally brought by provincial securities commissions or SROs. There is a sharing and overlapping of responsibilities between securities commissions and SROs. In addition, a market participant may have overlapping of responsibilities to multiple securities commissions and SROs and may face a number of investigations by different regulators for the same set of facts.

#### ii Procedure

These securities regulators may bring allegations of securities misconduct to a hearing before an adjudicative panel of the securities commission or SRO and seek monetary sanctions, suspensions and prohibitions as market participants.

In some jurisdictions, staff of the provincial securities commission may directly prosecute cases of a quasi-criminal nature in court. In others, these cases may be referred to public prosecutors for prosecution in the courts.

Enforcement staff of provincial securities commissions investigate possible market misconduct or breaches of securities legislation under an investigation order issued by the chair (or a designate) of the Commission. The order sets out the scope of the investigation. To carry out their investigation, enforcement staff have the power to compel the production of documents and testimony.

Generally, when an investigation order or examination order is issued, information about the investigation or any examination or evidence of a person must not be disclosed to anyone other than the counsel representing the examined person. The only exception is where a formal request is made to the provincial commission and the commission consents to disclosure by issuing an order.\textsuperscript{29}

Depending on the nature of the matter and the evidence they have gathered, enforcement staff may initiate a proceeding before the relevant commission,\textsuperscript{30} or prosecute a respondent for a breach of securities legislation by initiating a quasi-criminal proceeding in the court.

A public proceeding begins with the issuance of a notice of hearing regarding a statement of allegations, which must be proven at a public hearing or resolved by public settlement agreement. Rules applicable to the conduct of hearings and related procedural issues are set out in rules of practice applicable to each commission.

Both MFDA and IIROC also have their own rules of procedure applicable to their proceedings, which vary, in some instances, from those of provincial securities commissions.

\textsuperscript{27} CBCA, Section 241.

\textsuperscript{28} BCE Inv v. 1976 Debenture holders, 2008 SCC 69 (CanLII).

\textsuperscript{29} For example, OSA, Section 17.

\textsuperscript{30} For example, OSA Section 127.
iii Settlements

Enforcement staff of the multiple Canadian regulators negotiate settlement agreements under which respondents agree to sanctions. Settlement agreements usually involve an agreed statement of facts, admissions of a regulatory breach and an agreed-upon sanction (which can include a reprimand, fine, costs, and bans on or suspension from trading and other activities). Further, settlement agreements act as a waiver of the right to appeal.

The process for approval of a settlement agreement may be set out in the applicable rules of procedure for that regulator. By way of example, Rule 12 of the Rules of Procedure of the Ontario Securities Commission sets out the process for settlements with that commission.

A settlement agreement is submitted for approval by a panel or a single commissioner. One or more confidential conferences may be held. A notice of hearing for a settlement hearing is then issued and a public settlement hearing takes place. If the panel is satisfied the agreement is in the public interest, the agreement will be approved. Reasons for the decision will also be provided.

In Ontario, the Revised Credit for Cooperation Program (released in March 2014)\(^{31}\) allows for no-contest pleas with the Ontario Securities Commission (OSC). This does not exist in other provinces, where no-contest pleas are not allowed by those commissions.

Although investor restitution is not directly within the power of these public remedies, it is a common element of public settlement agreements and a mitigating factor to sanctions.

iv Sentencing and liability

In addition to monetary sanctions, provincial securities commissions may suspend or revoke registration. They may also issue cease trade orders, prohibit individuals from acting as officers or directors or prohibit individuals from trading in securities.

In the event of SRO rule violations, the SROs may impose administrative penalties, which include membership suspension or revocation, restrictions and fines. By way of example, IIROC has issued Sanction Guidelines. Its fines are limited to a maximum of 5 million Canadian dollars per contravention or an amount equal to three times the profit made or loss avoided. In general, either a disciplined individual or IIROC enforcement staff can appeal IIROC disciplinary decisions to the relevant provincial or territorial securities commission or the applicable reviewing body. An appeal will involve a review of the merits of the liability or penalty decision, or both.

In Alberta and Prince Edward Island, an SRO may register a ‘decision’ with the superior court with the result that it then has a civil judgment against the member that it can enforce, like all civil judgements.

IV CROSS-BORDER ISSUES

Certain provincial securities commissions have signed multiple memoranda of understanding with a number of foreign securities regulators. These include the United States Securities and Exchange Commission, the Financial Industry Regulatory Authority, the United States Commodity Futures Trading Commission, the Australian Securities and Investments Commission, Autorité des Marchés Financiers de France, Abu Dhabi Global Market

Financial Services, the Financial Conduct Authority, European Union authorities (including the European Securities and Markets Authority), the International Organization of Securities Commissions, the China Securities Regulatory Commission and the Hong Kong Securities and Futures Commission.

A common issue is whether a Canadian province can assume jurisdiction over securities issues involving foreign residents or jurisdictions. This issue has received the following recent judicial treatment.

A class action was proposed against HSBC Holdings by investors in HSBC Holdings’ shares or its American depository receipts (ADRs). The purchases were made on foreign stock exchanges. The allegation was that investors overpaid for their ADRs because HSBC holdings, which is regulated by foreign regulators, made false disclosures. It was held that an Ontario company does not carry on business in Ontario only by virtue of the fact that it owns shares of a subsidiary that operates in the jurisdiction. Further, it was found that even though the alleged misrepresentation was made in Ontario, it did not constitute a real and substantial connection to Ontario as such a finding would amount to universal jurisdiction for claims arising out of commercial activities. Lastly, the court also emphasised that it would have otherwise declined jurisdiction on the grounds that the United Kingdom was the more appropriate forum, as most of the trading occurred on the London Exchange and the corporation was based in the United Kingdom, where most of the witnesses and evidence were located. The defendants were awarded approximately C$1 million in costs.32 The appeal was dismissed. Among the Ontario Court of Appeal’s rationale was that the legislature did not intend that ‘Ontario would become default jurisdiction for issuers around the world whose securities were purchased by residents of Ontario’. In addition, the ability to download disclosure material from a home computer in Ontario did not establish a connective factor.33

In another case, the Ontario Court of Appeal allowed a class consisting mostly of non-resident investors to proceed in an action against an accounting firm. In this case, the investor class, which was predominantly resident in the United States, had invested in a US company, Southern Livestock International Inc (Southern Livestock), whose subsidiaries owned farming operations in China. Southern Livestock retained a New York-based investment bank to solicit investors. The investment bank distributed a private placement memorandum to accredited investors, which included an audit report by the accounting firm named as the defendant to the class action. The accounting firm was sued for an allegedly negligent audit report. The Ontario Court of Appeal held that Ontario had jurisdiction because the defendant was resident in Ontario, the report was prepared in Ontario and the class comprised a discrete body of investors.34

The Canada Cannabis Act35 renders it legal to possess, consume, produce and distribute cannabis across Canada as of 17 October 2018. There are multiple cannabis companies dually listed in Canada and in the United States, exposing them to the risk of being subject to multiple civil and regulatory proceedings in both jurisdictions based on substantially the same facts and allegations.

32 Yip v. HSBC Holdings PLC, 2017 ONSC 6848 (Can LII).
33 Yip v. HSBC Holdings PLC, 2018 ONCA 626.
34 Excalibur Special Opportunities LP v. Schwartz Levitsky Feldman LLP, 2016 ONCA 916.
35 S.C. 2018 c. 16.
V YEAR IN REVIEW

i Private remedies

Primary and secondary market liability

An investor plaintiff’s class action against a defendant exchange-traded fund (ETF) provider was dismissed.36 The main cause of action was the breach of an alleged duty of care owed by the ETF manufacturer and manager to investors by selling an ETF that was allegedly too risky to be actively managed. The court held that the relationship between the investor and the ETF fund was limited in light of the lack of warranty or guarantee of returns. The prospectus described the ETF as speculative and high risk and did not undertake to actively manage the ETF or stop investor losses. The relationship was described as one between a product vendor and purchaser, which is typically addressed by way of contractual obligations rather than tort claims for economic loss. In addition, the action plead a cause of action pursuant to Part XXIII of the OSA, which, as explained above, imposes civil liability for misrepresentation in the primary market. The court concluded that the only connection between ETFs and the primary market was that it required the filing of a prospectus and issuance of receipt by the appropriate regulator. Otherwise, ETFs traded on the secondary market, where the purchases occurred. No secondary market liability claim had been made pursuant to Section 138.1, Part XXIII.I of the OSA, which, as also stated, imposes liability for secondary market disclosure without regard to reliance by the purchaser.

Part XXIII.I of the OSA was considered by the Ontario Superior Court in the context of whether investors in a Chilean gold mine could obtain leave to commence a class action against a gold company.37 Investors alleged that relevant information was omitted from public reporting, with partially true contradictory information later released. The court held that the test for leave, though meant to prevent non-meritorious claims from burdening the justice system, is not an onerous one. The court stated: ‘the judge may say to herself that the chances of the defendant succeeding at trial are excellent – 80 or even 90 per cent. This still leaves a 10 to 20 per cent chance of success for the plaintiff, enough to clear the “reasonable possibility” hurdle.’ The alleged misrepresentation that the court held met the test for leave was argued by the defence to comprise a legal opinion. This argument was rejected on the basis that there was no language to qualify it as an opinion and based on American jurisprudence that, in any event, opinions can contain facts, which in turn can be misrepresented.

Another investor plaintiffs’ class action was also dismissed against an investment adviser, dealer and related personnel alleging in part a ‘one size fits all’ investment strategy, largely in energy securities and some private equities, that was unsuitable for investors and a failure to supervise.38 The court held in part that:

[52] Different clients likely would have had differing risk tolerances, objectives, and time horizons depending on their personal circumstances and the composition of their investment portfolios. In addition, some clients may have purchased or sold securities based on information or advice received from sources other than [the investment advisors].

36 Wright v. Horizons ETFS Management (Canada) Inc., 2019 ONSC, 3827 (Can LII).
37 DALI Local 675 Pension Fund (Trustees) v. Barrick Gold, 2019 ONSC 4160.
38 Fisher et al. v. Richardson GMP et al., 2019, ABQB 450.
These facts are essential to the nature, scope, and extent of the duty each Defendant owed to members of the Proposed Class. The result is that the suitability claims are personal to each client and this factual matrix makes identification of the class complicated and problematic.

Although the court identified various common issues, it held that a class action was not the preferable procedure because these issues did not materially advance the proceeding, rendering individual assessments after a trial still necessary to determine whether any particular class member had a compensable claim. The case confirmed that allegations of unsuitable investment advice raise issues intrinsically individualistic to each investor’s personal and financial circumstances and are, therefore, not appropriate for certification.

In contrast, certification was granted in a class action brought against the trustee and manager of certain mutual funds on behalf of holders of those mutual funds through a discount broker. The claim sought damages and other relief related to the payment of allegedly unearned management fees. The key allegations relied in part on duties allegedly owed pursuant to trust agreements and representations allegedly made in Fund Facts and Simplified Prospectuses in the relevant period.39

**Corporate governance**

The OSC has encouraged the creation of Special Committees early in any process involving a potentially material conflict of interest transaction, such as going private transactions by management or large shareholders, in accordance with Multilateral Instrument 61-101-Protection of Minority Security Holders in Special Transactions.40 In its decision, the OSC has also advised that if a board establishes a special committee when it is not legally required to, the disclosure related to its process will be subject to the same scrutiny as if a special committee was strictly necessary.

**Public remedies**

**With regard to pending litigation**

Canadian regulators continue to refuse to grant a stay where their proceedings arise from the same facts as pending litigation.41

**With regard to insolvency**

The Alberta Queen’s Bench held that administrative penalties imposed by the Alberta Securities Commission (ASC) against an individual survived his discharge in bankruptcy.42 Exceptions pursuant to the Bankruptcy and Insolvency Act include (1) fines or penalties imposed by a court; (2) debt or liability arising out of fraud, embezzlement, misappropriation, or misappropriation while acting in a fiduciary capacity; and (3) debt or liability arising from obtaining property or services by false pretences or fraudulent misrepresentation. The underlying policy consideration was that a debtor who has engaged in fraudulent or dishonest conduct is not entitled to a fresh start offered by a general discharge of bankruptcy. The court stipulated that not all regulatory penalties would survive discharge. In this instance, the

39 Stenzler v. TD Asset Management Inc., 2020 ONSC, 111.
40 The Catalyst Capital Group Inc. (Re), 2020 ONSEC 6.
41 Re: Lutheran Church-Canada, the Alberta-British Columbia District, 2019 ABASC 43.
individual had misrepresented financial statements, participated in market manipulation, not abided by insider trading reporting requirements, benefitted from investor funds and made misrepresentations to the ASC.

In lieu of payment to the ASC, administrative penalties have been paid to the Monitor in the context of the Companies’ Creditors Arrangement Act43 for distribution to investors.44

**The first publicly offered bitcoin fund**

The cryptocurrency landscape continues to evolve worldwide. On 29 October 2019, the OSC issued its reasons for the decision to allow a Canadian investment fund manager to offer the first publicly offered bitcoin fund in Canada.45 The OSC held that although the risks of price manipulation in the bitcoin market exist, in this instance, the risk was mitigated, in part, by the fund’s investment parameters and restrictions. In this regard, the fund’s prospectus stated that the fund would: (1) invest in bitcoin only, not in all crypto-assets; (2) pursue a buy and hold strategy, not an active trading strategy; and (3) only buy and sell bitcoin on regulated exchanges. A qualified auditor could also conduct an audit based on other evidence obtained from third parties to comply with generally accepted accounting principles. From a policy perspective, the OSC held that a refusal of the opportunity to invest in bitcoin through a public fund might lead to the suggestion that investors should acquire bitcoin through unregulated vehicles. The OSC supported the notion of professionalising the investment in risky assets through a publicly regulated fund to mitigate risk.

**VI OUTLOOK AND CONCLUSIONS**

**i Regulatory burden reduction**

On 27 June 2019, the ASC issued a Consultation Paper 11-701, Energizing Alberta’s Capital Market (ASC Consultation Paper) recognising the province’s significant representation in the energy sector, pipeline and related services and setting out a series of preliminary recommendations to reduce ‘red tape’ and stimulate economic growth in its traditional areas and in new areas. The results of the Consultation Paper are pending.

On 19 November 2019, the OSC released its report, Reducing Regulatory Burden in Ontario’s Capital Markets, in response to its solicited feedback from various stakeholders and outlining specific ways in which the OSC would reduce unnecessary administrative burden on Ontario market participants (OSC Report). The OSC Report comprised 107 broad ranging decisions and recommendations, the full potential benefits will be subject to market assessment over time.

**ii Client-focused reforms**

On 3 October 2019, the CSA released final rule amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and the associated Companion Policy (the Client-Focused Reforms), which came into force on 31 December 2019 and become effective over phased-in transition periods of two years ending

43 RSC 1985, c C-36. This is a federal Act that provides avenues for financially distressed corporations to restructure their affairs.
44 Re Lutheran Church–Canada, the Alberta-British Columbia District, 2019 ABASC 140.
45 3iQ Corp. (Re), 2019 ONSEC 37.
31 December 2021. IIROC and the MFDA are expected to amend their rules within that time frame. The Client-Focused Reforms imposed enhanced know your client, know your product, suitability, training, conflicts management, record keeping, policies and procedures and internal control obligations on market participants across registration categories involved in distribution. The impact of the Client-Focused Reforms on these market participants is currently unknown, but expected to pose challenges for smaller market players in particular.

iii  Covid-19

At the time of writing, global markets are in the midst of the covid-19 outbreak, to which Canadian securities regulators, government and market participants are seeking to respond as the situation evolves.
Chapter 5

CHINA

Zhou Yuhua¹

I OVERVIEW

i Sources of law

In the past 20 years of the formation and development of China’s securities market, a large number of relevant laws and regulations have been promulgated. The securities market laws and regulations system was initially established with the Securities Law as the core, including administrative laws and regulations, departmental rules and normative documents of the securities market, covering securities, futures, securities investment funds and other fields, and it plays an important role in the regulation and orderly development of the securities market. The Securities Law is the fundamental law of the securities market. It stipulates the illegal acts of securities and their liabilities.

ii Regulatory authorities

The regulatory body of China’s securities market is China’s Securities Regulatory Commission (CSRC), which is responsible for formulating the rules and regulations of the Chinese securities market. Participants in the securities market include issuers, investors and intermediaries (securities companies, securities service agencies, accounting firms, law firms, etc.) and self-regulatory organisations (the stock exchanges, securities industry associations, securities registration and settlement institutions). There are two stock exchanges in China (Shanghai and Shenzhen), which are responsible for providing trading venues and facilities, supervising the compliance and legality of the securities listed on the exchange and the trading behaviours of its members, and ensuring the openness, fairness and justice of the trading market. The administrative supervision institution shall be responsible for the administrative punishment of the main body of the securities market. The courts are responsible for the civil trial of securities disputes and the criminal punishment of securities crimes.

iii Common securities claims

According to the Securities Law of China, there are four kinds of securities frauds in China’s securities market: insider trading, market manipulation, customer fraud and misrepresentation. In addition, there are other illegal behaviours, such as issuing securities without authorisation, providing financing and overdraft for stock trading without authorisation, buying and selling shares of the company by listed companies without authorisation, and changing the purpose

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of funds raised by listed companies without authorisation. Any subject who is engaged in illegal securities acts faces administrative penalties and civil liability, and if the circumstances are serious, will be subject to criminal sanction.

In the new Securities Law, the applicable conditions for the initial public offering of a company have changed significantly, and the original standard of ‘having sustained profitability’ has been revised to ‘having sustained operation ability’. The requirement for financial accounting report is changed from ‘no false record’ to ‘the financial accounting report of the last three years has been issued with unqualified opinion audit report’. In the new securities law, the factors of financial substance judgment are removed from the issuance conditions and adjusted to form elements that further reflect the position that the stock exchanges do not make substantive judgment on the financial reality of the issuer and do not endorse the liability of the issuer. In essence, this strengthens the responsibility of information disclosure obligors of issuers and intermediaries. The new securities law has significantly increased the punishment for the agency failing to fulfil the duty of diligence. If ‘the sponsor issues a letter of recommendation with false records, misleading statements or major omissions, or fails to perform other legal duties’, the fine standard will be increased from one to five times the original business income to ‘one to ten times’, while the business income will be confiscated. The new Securities Law also establishes the presumption of fault liability for information disclosure violations. In the event that investors suffer losses in securities trading due to violation of credit and information disclosure rules, in addition to the liability of compensation, the: controlling shareholders, actual controllers, directors, supervisors, senior managers and other directly liable persons of the issuer, as well as the sponsors, underwriting securities companies and their directly liable persons shall bear joint and several liability with the issuer, except that he or she might be able to prove that he or she is not guilty.

II PRIVATE ENFORCEMENT

i Forms of action

There are four means of resolving securities disputes:

a administrative, which requires the securities regulatory authorities to impose administrative penalties or other sanctions on the responsible units and personnel;

b civil mediation, which requires the mediation organisation designated by the securities regulatory authorities to preside over the mediation;

c civil litigation, which requires the civil court to judge the responsible personnel to bear the liability for damages; and

d reporting to the public security prosecutor to initiate criminal prosecution proceedings and investigate the criminal responsibility of the responsible personnel.

The actual controller, controlling shareholders, directors, supervisors and intermediaries of listed companies need to bear joint and several liabilities, and the chances of being sued will increase in the future. Regarding the principle of liability for civil compensation for misrepresentation and other fraudulent actions of securities companies, accounting firms, law firms and other intermediary organisations, and controlling shareholders, actual controllers, directors, supervisors and sponsors of listed companies, the new Securities Law changes the original ‘fault principle’ to ‘fault presumption principle’, which further reduces the burden
of proof of investors. In the future it may become normal for investors to sue the controlling shareholders, actual controllers, directors, supervisors and senior management of listed companies and intermediary agencies, which bear joint and several liabilities.

Due to the fact that most courts still strictly apply the provisions of judicial interpretation of misrepresentation in the pre-procedure of civil litigation of securities misrepresentation, cases in which intermediary agencies were adjudged to bear joint and several liability were relatively rare in the past. Previously, only Lixin Accounting was adjudged to bear joint and several liability in the *Big Wisdom*² and *Geeya Technology*³ cases. However, in 2019, courts have successively made judgments on the cases of intermediary agencies as co-defendants.

For example, in the Kunming Machine Tool case, the Yunnan Higher People’s court decided that the securities company should bear joint and several liability for the losses of investors. In a further example, in the case of a false securities statement liability dispute heard by Chengdu Intermediate People’s Court, the first trial decision of the court involved securities companies and accounting firms respectively bearing joint and several liabilities of 40 per cent and 60 per cent of the compensation obligations of listed companies.

**ii Rapid increase in the number of securities litigation cases**

According to the provisions on the cause of civil cases issued by the Supreme People’s Court, the cause of action of securities civil compensation litigation is mainly securities fraud liability disputes, including securities insider trading liability disputes, manipulation of securities trading market liability disputes, false securities statement liability disputes and customer fraud liability disputes.

As of 25 December 2019, 19,662 securities fraud dispute cases can be retrieved from China’s judicial document and litigation website, including 5,734 judgments, 13,918 rulings and 10 mediation letters. In securities fraud disputes, the cases mainly focus on securities misrepresentation liability disputes. From 2001 to 2019, the number of securities misrepresentation liability disputes gradually increased from 2,517 in 2001 to 9,005 in 2019.

**iii The record claim amount in a single case and cumulative claim amount in a series of cases**

While the number of listed companies involved in litigation and the number of shareholders’ claims have reached a new record, the amounts claimed in civil cases of securities misrepresentation have been constantly rising. In single civil cases of securities misrepresentation heard in 2019, the maximum claim amount in a case with natural person investors as the plaintiff was 66 million yuan. As of the end of October and November 2019, the cumulative claim amount of the securities misrepresentation civil litigation cases involving Big Wisdom and Erkang Pharmaceutical has reached 638 million yuan and 535 million yuan respectively.

A sharp increase in the number of cases involving litigation between intermediaries and directors, supervisors and senior executives of listed companies

Under the old Securities Law, the responsibilities of directors, supervisors and senior managers of listed companies and intermediaries were not clearly defined. The court usually holds the listed company liable. Most people think that the responsibility of directors, supervisors and senior executives should be borne by the listed company because they vote according to the will of shareholders.

Under the influence of the declining economy, the performance of companies has been sluggish and their compensation ability is declining. However, in many cases, investors no longer regard the listed company as the 'guaranteed bottom' choice for prosecution and claims, but also list the intermediary agencies and other responsible subjects of the board of directors and supervisors of the listed company as joint defendants. Taking the cases involving 88 listed companies in 2019 as an example, accounting firms have been listed as co-defendants in at least 15 series of cases. Securities companies have been listed as co-defendants in at least 13 series of cases. In at least 40 series of cases, directors and supervisors of listed companies have been listed as co-defendants. Individual intermediary agencies have also become joint defendants in a series of cases because they have been punished by the CSRC more than once.

Judicial practice

Civil litigation cases of securities misrepresentation entered a 'blowout period' in 2019. Pressure on trials in the people's court has increased greatly. In the past, the practice of putting on record, hearing and settling cases of 'one case, one trial' and 'one case, one conclusion' have lagged behind the needs of judicial practice for such cases.

'The Notice on the Acceptance of Civil Tort Cases Caused by False Statements in the Securities Market' issued by the Supreme People's Court on 15 January 2002, stipulates that the people's court shall accept civil compensation cases for false statements in the form of separate or joint litigation, rather than group litigation. Therefore, investor securities civil compensation litigation still adopts the practice of 'separate filing and separate trial', which also leads to the same listed company potentially facing dozens to thousands of securities civil compensation disputes under the same cause after being punished by the administrative body.

For example, after a company's senior executives' financial fraud was investigated by the CSRC, the first batch of investors filed a lawsuit on 8 February 2003, and within the limitation of action period that expired in January 2005, the compensation case involved a total of 7,000 plaintiffs in more than 20 provinces, cities and autonomous regions. On 25 August 2007, the company announced that it had signed 6,591 civil mediation documents and 66 civil ruling documents.

There have been other examples. In 2013, more than 2,500 shareholders filed claims after a company and related personnel in Guangdong were punished by the CSRC for information disclosure violations. In May 2015, a company in Shanghai announced that it was put on file for investigation by CSRC due to suspected information disclosure violations. In July of 2016, the CSRC issued a decision on administrative penalty that determined that the company's behaviour constituted a false statement. As a result, more than 4,000 shareholders participated in claims in batches. As of 30 September 2019, total compensation of 166 million yuan has been awarded. At present, the Shanghai Financial Court and
Shanghai High Court are trying follow-up cases in batches. According to the above data and judicial cases, at present, China’s securities civil compensation litigation mainly adopts the procedure of ‘one case, one case, one trial separately’.

vi Procedure
The Supreme People’s Court clearly stipulated in the notice on the acceptance of civil tort cases caused by false statements in the securities market that the filing of civil compensation cases for false statements in securities must be subject to the penalty decision made by the CSRC and its local offices as a pre-processing procedure. The court usually takes administrative punishment as the premise of accepting civil cases, which greatly limits the investors’ right of action. In the above notice, the Supreme People’s Court also stipulates that the court in the place where the defendant is located shall have jurisdiction over the civil proceedings against the listed companies and securities companies. However, it is very difficult to gather small and medium-sized investors as the principals in securities civil disputes because of their large number and wide regional distribution. Before the implementation of the new Securities Law, there was no class action system in China’s civil dispute system, only separate action and joint action. It is more difficult for investors to safeguard their rights by taking a group action. However, with the introduction of the collective action system after the issuance of the new Securities Law, investors’ rights protection is expected to improve.

vii Settlements
Settlement can be divided into the following two types: that the investors and the securities issuers reach an agreement on compensation, which mainly depends on the voluntary performance of the parties; or that the administrative body and the judicial body jointly (or the judicial body alone) preside over a reconciliation agreement between the investors and the securities issuers, which has a certain degree of enforcement, and the non-performers will bear the adverse consequences. At present, the industry associations and specialised agencies are mainly engaged in the mediation of securities and futures disputes. Industry associations include national industry associations, such as securities and futures funds and local industry associations, and specialised agencies include national institutions and some local institutions. Currently, there is no clear judicial review standard on settlement agreements and attorneys’ fees in China, but the principle of fairness and justice and the principle of parties’ voluntariness should be followed as a whole.

viii Damages and remedies
The scope of investor’s compensation for losses in the issuing market is the amount of shares bought by the investor and the interest on current deposits in the bank in the same period. The scope of investor’s compensation for losses in the trading market is limited to the actual losses, specifically including three components: (1) the loss of investment balance; (2) commission and stamp duty on the loss of investment balance; and (3) the interest loss of the two funds mentioned in the preceding items from the date of purchase to the date of sale of securities or the base date calculated according to the current deposit interest rate of the bank for the same period. Among the above three compensation ranges, the calculation is more complicated: investment difference loss = (average price of purchased securities – average price of sold securities) × number of securities held by investors. This calculation method is applicable to the situation in which investors sell securities on or before the base date. Investment difference loss = (average price of purchased securities – average closing price of each trading
day from the disclosure date or correction date to the base date) \times \text{number of securities held by investors} This calculation method is applicable to the conditions for determining the benchmark date when investors sell or still hold securities after the benchmark date: (1) from the disclosure date or correction date to the date when the cumulative turnover rate of the stocks affected by the misrepresentation reaches 100 per cent of the tradable part, but the bulk trading is not calculated; (2) if the turnover rate cannot be determined to reach 100 per cent before the trial, the disclosure date shall be used, or the 30th trading day after the correction date shall be the base date; (3) if the market has been delisted, the trading day before the delisting date shall be the base date; and (4) if the transaction has been stopped, the trading day before the suspension date shall be the base date; if the transaction is resumed, the base date may be determined in accordance with item (1).

III PUBLIC ENFORCEMENT

i Forms of action

Supervisors may impose administrative penalties or other compulsory measures on violators in accordance with administrative laws and regulations, and may also report and accuse those who constitute crimes to public security bodies. After the investigation, the public security body shall submit the case to the prosecutor for public prosecution and investigation of the criminal responsibility of the violator.

The CSRC reached an administrative settlement with nine subjects, including Goldman Sachs Asia and Gao Hua Securities, in April 2019. This was the first successful settlement case in more than four years since the CSRC issued the measures for the implementation of administrative settlement pilot in February 2015 (the measures for implementation), which has achieved a breakthrough and is a milestone in history.

With the approval of the State Council, the CSRC has formulated the measures for implementation and, together with the Ministry of Finance, the interim measures for the administration of administrative settlement funds. Relevant measures have specified the scope and conditions of application of administrative settlement, settlement consultation, signing, implementation and supervision of administrative settlement agreements, determination, management, use and supervision of administrative settlement funds, etc. Accordingly, the CSRC began to pilot the administrative settlement system in the field of securities and futures.

During the period from 8 October 2013 to 3 July 2015, Goldman Sachs Asia proprietary traders traded through the Goldman Sachs brokerage account opened in Gao Hua Securities, and provided business guidance to Gao Hua Securities’ proprietary traders. During four trading days in May and July 2015, the two parties engaged in the trading of other relevant stock and index futures contracts. The CSRC filed an investigation into the above behaviours of the applicant in July 2016. After the CSRC and the relevant settlement applicant of Goldman Sachs reach an administrative settlement agreement in April 2019, the investigation and trial procedures for the relevant behaviours of the applicant were terminated in accordance with the provisions. The administrative settlement applicants involved shall pay 150 million yuan of administrative settlement and take necessary measures to strengthen the internal control management of the relevant companies.
ii Procedure

The salient procedural features of a securities-related enforcement action or criminal prosecution are as follows.

a A securities-related enforcement action or criminal prosecution is an activity guaranteed by national coercive force.

b Administrative and criminal proceedings shall be conducted by special state bodies.

c Administrative and criminal proceedings must be conducted in accordance with legal procedures.

d The severity and compulsion of punishment. The administrative penalty will be a high fine. Criminal punishment usually deprives the defendant of personal freedom and property.

There are many differences between regulatory actions and criminal prosecutions and private civil actions.

a The main body is different: the agency that makes the decision regarding administrative or criminal penalty is the administrative body or the judicial body. Civil compensation or compensation litigation is carried out among the natural or legal persons with equal civil subjects.

b The legal basis is different: the basis of administrative or criminal punishment is administrative and criminal laws and regulations. The basis of civil compensation is civil laws and regulations.

c Different procedures. Generally, administrative punishment must go through four steps: summons, interrogation, evidence collection and adjudication. If the administrative body violates the legal procedure in the process of penalty, the opposing party may bring an administrative lawsuit. According to the provisions of the criminal procedure law and other relevant laws, in general, the public security body is responsible for filing and investigating criminal cases, the prosecutor is responsible for examining and prosecuting and initiating public prosecution on behalf of the state, the court is responsible for hearings, and finally the prison service is responsible for executing the punishment. If there is a dispute over civil compensation or compensation, and civil litigation is instigated, the Civil Procedure Law shall apply.

d The methods of punishment are different. The forms of administrative punishment include fines, and detention. Criminal punishment consists of two parts: the main punishment and the additional punishment. The main punishments are public surveillance, criminal detention, fixed-term imprisonment, life imprisonment and the death penalty. Additional punishment includes fines, deprivation of political rights and confiscation of property. Civil compensation includes financial compensation, apology, elimination of influence, cessation of infringement, etc.

iii Settlements

In May 2016, the Supreme People's Court and the CSRC jointly issued a notice on the pilot work of multiple resolution mechanisms for securities and futures disputes in some regions of the country (Law [2016] No. 149). The Supreme People's Court and CSRC jointly determine the pilot mediation organisation system. Mediation organisations initiated and actually managed by securities and futures regulatory agencies and industry organisations can become pilot mediation organisations. In the process of cleaning up and handling mass disputes, securities and futures regulatory agencies may entrust pilot intermediation organisations to
central conciliation with regard to matters related to investor rights protection. A mediation agreement that meets the legal conditions may serve as the basis for the parties to apply to the basic people’s court with jurisdiction for a payment order. If an investor applies for mediation to resolve a dispute, the operating entity of the securities and futures market shall actively cooperate in mediation. For securities and futures market operators who refuse to perform the mediation and reconciliation agreements without good reason, the securities and futures regulatory authorities shall check their relevant behaviours according to the law, investigate and deal with the illegal behaviours in a timely manner, and record them in the credit database of the capital market.

iv Sentencing and liability

The principle of actual loss is followed in the determination of civil litigation compensation. This refers to the securities fraudster being liable for the actual losses suffered by the investors due to the securities fraud. The Supreme People’s Court clearly stipulated in Article 30 of the notice on the acceptance of civil tort cases caused by false statements in the securities market:

> the scope of civil compensation liability of the person who makes false statements in the securities market shall be limited to the actual losses incurred by the investor due to the false statements. The investor’s actual loss includes (I) the loss of the investment balance; (II) the commission and stamp duty of the investment balance.

This is the embodiment of the principle of actual loss in legislation.

The main provisions of the criminal law include the crimes of:

- counterfeiting and altering stocks, companies and corporate bonds;
- issuing stocks, companies and corporate bonds without authorisation;
- insider trading and disclosing insider information;
- fabricating and disseminating false information of securities trading;
- luring investors to buy and sell securities;
- manipulating the price of securities trading;
- providing false documents by intermediary organisation personnel;
- providing false documents by intermediary organisation personnel; and
- material misrepresentation with supporting documents.

Different crimes correspond to different sentencing standards. For example, Article 180 of the criminal law stipulates that:

> the persons who know the insider information of securities and futures trading or who illegally obtain the insider information of securities and futures trading shall buy or sell the securities or engage in the activities related to the insider information before the information concerning the issuance of securities, securities and futures trading or other information having a significant impact on the price of securities and futures trading has not been made public. Whoever trades futures or divulges such information, if the circumstances are serious, shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention and shall also, or shall only, be fined not less than one time but not more than five times the illegal income; if the circumstances are especially serious, he shall be sentenced to fixed-term imprisonment of not less than five years but not more than 10 years and shall also be fined not less than one time but not more than five times the illegal income.
Once the crime accusation is established, the judge determines the specific penalty according to the seriousness of the crime and the different sentencing grades stipulated in the criminal law.

IV CROSS-BORDER ISSUES

The ‘long-arm jurisdiction’ clause has been added to the new Securities Law. If securities issuance and trading activities occurring outside China disrupt the market order within the territory of China and damage the legitimate rights and interests of domestic investors, they shall be dealt with and investigated for legal responsibility in accordance with the relevant provisions of this law. For the first time, the new securities law clarifies the extraterritorial effect of the Securities Law, which is a pioneering institution. However, the new Securities Law does not specify the specific procedure, which requires the judicial and regulatory authorities to work together to create a long-arm jurisdiction system in line with China’s national conditions. It may be anticipated that the relevant cases will inevitably be major foreign-related financial cases. The complexity of their legal relationship and the wide range of interests involved will bring new challenges to judicial work.

V YEAR IN REVIEW

China’s top legislature recently passed the revised version of the Securities Law, which took effect on 1 March 2020. This is the second comprehensive amendment to the law since it came into force in 1999. The law was first revised in 2005, and work on the second amendment began in 2013. The amended law will treat the registration system as a cornerstone of a fair market, cancels the issuance examination committee and authorises the State Council, China’s Cabinet, to promulgate stipulations on the specific scope of the securities issuance registration system. The amended law will also set the legal basis for China to expand the pilot registration-based system for initial public offerings in the A-share market and better implement the de-listing system in the securities market.4

In particular, to meet the needs of the reform of the securities issuance registration system, the securities class action system was formally introduced in the new Securities Law to protect the interests of small and medium-sized investors. The investor protection institution may, as the litigation representative, file a civil compensation lawsuit for the injured investor in accordance with the litigation principles of express withdrawal and implied participation. In the future, the China Securities Protection Center for small and medium investors has the right to file a civil claim on behalf of more than 50 small and medium-sized investors against a listed company that has committed illegal acts such as misrepresentation, without the need for additional authorisation or registration by the investors, and can register with the court according to the register confirmed by the securities registration and settlement institution. If the investors do not explicitly withdraw, the effective judgment or ruling shall have effect on the registered investors. It is anticipated that once the system is supported by the people’s court and finally implemented, the civil litigation of securities infringement in China will undergo fundamental changes, and the person who makes a false statement may face an ‘all people’s claim’.

4 https://global.chinadaily.com.cn/a/202001/03/WS5e0c7b9a310cf3e3558229a.html.
VI OUTLOOK AND CONCLUSIONS

China’s new Securities Law includes a registration-based initial public offering (IPO) system and class actions, which will have a profound impact on the development of the securities market. From now on, there might be an increasing trend towards civil litigation of securities misrepresentation after the revision of the law.

i Administrative illegality and securities infringement

According to Article 85 of the minutes of the ninth civil and commercial meeting of the judicial system, ‘if a false statement has been subject to administrative punishment by the regulatory authority, it shall be deemed as a major illegal act.’ Based on the above provisions, it is anticipated that in the future the number of cases in which the court will finally recognise administrative violations as securities violations will increase. The People’s Court will accept the civil claim for the illegal act of securities only if the administrative body punishes it.

However, we understand that the above provisions emphasise the importance of punishable administrative violations. That is, the People’s Court should not challenge the determination of the significance of administrative illegal acts in civil trials. However, there are differences between administrative liability and civil liability in terms of constitutive requirements, protection of legal interests and recognition standards. The people’s court still has the right to examine and judge whether the administrative illegal act of punishment definitely affects the investors’ investment decision-making and securities trading price according to the specific circumstances of the case. Once the new or revised judicial interpretation formally cancels the pretrial procedure of securities litigation, the major issues will become the core dispute focus of such cases again.

ii Case investigation and share price change

Article 84 of the minutes of the ninth civil and commercial trial working conference stipulates:

As long as the trading market has a clear reflection on the information such as the case investigation of the regulatory authorities and the disclosure articles published by the authoritative media, the people’s court shall support one party’s plea that the market has known the false statement according to law.

According to the above provisions, the determination of the disclosure date of false statements seems to have been greatly simplified. However, whether the provisions conform to the original intention of the judicial interpretation of misrepresentation on the disclosure date and whether they are fair and reasonable is still open to question and debate.

In China’s securities market, the investigation of listed companies on file itself constitutes a major negative. No matter whether the investigation ends with formal punishment or with case withdrawal, the securities market will react strongly to the information of ‘investigation on file’. In fact, the decline in a stock price after the announcement of filing investigation information is not necessarily due to the fact that the false statement is known by the market, but is often caused by the major bad news of being filed for investigation or other factors besides the false statement. Therefore, it is questionable that the announcement of the case investigation constitutes the disclosure of the false statement simply because the share price drops after the case investigation.
iii The trading causality of securities misrepresentation

For investors who buy shares between the implementation date and the disclosure date, the court no longer simply believes that their trading decisions are all induced by false statements. The court will analyse the specific situation of the case involving false statements and the trading behaviour of investors, and prudently determine whether there is a causal relationship between the investors’ investment decisions and false statements.

For example, in the Youjiu Game case, the Shanghai Financial Court held that if the information involved does not have a substantial impact on the investors’ investment decisions and stock prices, resulting in investors’ losses, then there is no causal relationship between the administrative violation and investors’ losses. In another example, in a dispute case of liability for misrepresentation of securities heard by the Chongqing Higher People’s Court, the court held that the time for the plaintiff to buy shares was mainly after the listed company issued a series of major good news and the stock market became bullish in the second half of 2014, indicating that the investment behaviour of the investors was not affected by the matters of holding shares on behalf of the investors, and the investment loss of the investors and the behaviour involved in the case indicated that there was no causal relationship. In the retrial of Shunhao Shares, the Supreme People’s Court ruled that the original judgment did not fully consider the causal relationship between the two false statements implemented by Shunhao Shares and the investor’s trading decision, meaning that the basic facts were unclear, and the original judgment was revoked and sent back for retrial.

iv Investors should bear their own investment losses caused by their irrational investment behaviour

If investors ignore the risks of the securities market and the real value of listed companies, and only buy stocks based on the illusory concept of speculation or blind expectation of obtaining excess return in a short period of time, this is irrational speculation in itself. There is no reason for listed companies to pay for the failure of this investment behaviour. We note that the above view that investors should bear the loss caused by their irrational investment behaviour has been recognised by more and more courts.

For example, in the Shanghai Rock case, the Shanghai Financial Court held that the plaintiff’s investment loss was caused by the joint action of Shanghai Rock’s misrepresentation and the plaintiff’s own irrational investment behaviour, and should be apportioned according to the proportion of causality, and accordingly, it was determined that 50 per cent of the plaintiff’s investment loss should be borne by the plaintiff. Further, in a dispute case of liability for misrepresentation of securities heard by the Higher People’s Court of Hunan Province, the court held that some investors bought shares during the period of abnormal fluctuation of the stock market, whether for the purpose of investment or short-term speculation, and by trading shares during the period of abnormal fluctuation of the stock market, they faced higher market risk and should bear corresponding investment risk.

Judging from the data on court decisions in securities fraud disputes, securities civil compensation litigation has been on the rise. The minutes of the 9th civil and commercial trial conference to the new Securities Law reflect the thinking of judicial and legislative bodies to promote the group action system of civil compensation. It is expected that in the near future we will see that the domestic courts will substantially implement group actions in this field.
I OVERVIEW

i Sources of law

The Danish regulation of securities law is highly influenced by Denmark's membership of the European Union and is based on implementation and direct application of EU regulations such as the MiFID II Directive, the MiFIR Regulation and the Market Abuse Regulation (MAR). The primary source of securities law in Denmark is the Capital Markets Act, which came into force on 3 January 2018 and replaced the former Securities Trading Act enacted in 1995. The Capital Markets Act provides the overall framework for securities trading in Denmark, including rules on offering and admission to trading (prospectus rules), disclosure of inside information and takeover bids. The Capital Markets Act is supplemented by a number of executive orders and guidelines, providing a more detailed regulation of specific topics. Other potentially relevant statutes include the Companies Act and the Financial Business Act.

In addition, trading at the Danish stock exchange, Nasdaq Copenhagen A/S (Nasdaq Copenhagen), is governed by the Issuer Rules, the Member Rules and the Warrant Rulebook.

Litigation of securities claims in Danish courts is not governed by a special set of procedural rules but by the general rules of civil and criminal procedure in the Administration of Justice Act (AJA). In practice, many securities actions start out with the Danish Financial Supervisory Authority (the Danish FSA) or Nasdaq Copenhagen issuing criticism on the basis of inquiries into potential issues. Such administrative orders or reprimands influence the dynamics of court cases. See Section III.

ii Regulatory authorities

The Danish Financial Supervisory Authority

The Danish FSA exercises unitary supervision of the actors in the financial markets in Denmark and ensures observance of the Capital Markets Act and rules issued pursuant thereto. In addition to its supervisory activities, the Danish FSA assists in drafting financial legislation and issues executive orders about the financial markets.
Nasdaq Copenhagen A/S

The Copenhagen Securities Exchange began trading in 1808 as a non-profit organisation. Today, the stock exchange exists in the form of the regulated market Nasdaq Copenhagen, which is the predominant stock exchange in Denmark.

Nasdaq Copenhagen also operates First North, an alternative marketplace in Denmark primarily for small growth companies seeking to develop their businesses. First North is subject to a separate and less burdensome rule book.

As at April 2020, 130 companies were listed on the main market of Nasdaq Copenhagen, and 24 companies were listed on First North (154 companies in total).

Judicial authorities

There are no specialist courts in Denmark dealing only with securities litigation. On the contrary, the Danish courts have jurisdiction over both civil and criminal securities actions. The Danish courts include:

a. 24 district courts;

b. the Maritime and Commercial High Court (a specialist court within the field of maritime, commercial and business law);

c. the Eastern High Court and the Western High Court; and
d. the Supreme Court.

As a general rule, civil and criminal cases are tried before the district court in the first instance. Only if a case raises issues of a fundamental nature may it be referred from the district court to the High Court in the first instance.

Court decisions may always be tried in two instances (the two-tier principle).\(^4\)

Bringing a case before the Danish Supreme Court in the third instance requires permission by the Appeals Permission Board (third-tier grant), which is only granted in cases that may have implications for rulings in other cases or cases of special interest to the public.

The Prosecution Service

The Prosecution Service is the prosecution authority with respect to criminal enforcement of securities law. There are 14 police districts in Denmark, including the Faroe Islands Police and the Greenland Police, where prosecutors appear before the district courts. Cases about serious economic crime are prosecuted in the High Court by the State Prosecutor for Serious Economic and International Crime.

Common securities claims

Private securities actions, as described in Section II.i, include actions in which investors are seeking damages for misleading or untrue statements in prospectuses or in other published information and actions about unjustified delay of disclosure of inside information. Such claims are typically directed at the issuer, the management or the board of directors; however, to some extent Danish case law also allows secondary liability as described further in Section II.i.

Within public enforcement and under the Danish FSA’s supervision, criminal market misconduct offences include:

\(^{4}\) AJA, Part 36 on appeals.
Furthermore, the application of MAR has resulted in increased formal requirements on the keeping and maintenance of insider lists and on documentation of notification of insiders and related parties, which the Danish FSA also supervises.

II PRIVATE ENFORCEMENT

i Forms of action

Prospectus liability

Section 12(1) of the Capital Markets Act sets out the fundamental requirement that a prospectus must include the information necessary to enable investors to make an informed assessment of the issuer and the rights attached to the securities.

The cause of action available to an investor seeking damages for misleading or untrue statements in prospectuses has been established by the Danish courts on the basis of the general Danish rule of non-contractual liability (culpa liability).

According to Danish case law, in particular the Danish Supreme Court judgment in Hafnia and the Danish Supreme Court judgment in BankTrelleborg, persons responsible for a prospectus may incur liability for investor losses caused by defects in the prospectus that, overall, are of significant importance to an investor's assessment of the issuer. It is further required that the defects are attributable to those responsible for the prospectus, and that those responsible acted intentionally or negligently.

With regard to causal nexus between the material defects in the prospectus and the loss suffered, the Danish Supreme Court established in BankTrelleborg that when a prospectus suffers from material defects, there is a presumption that the share subscription process would not have taken place had the information in the prospectus been correct and adequate. BankTrelleborg thus places the burden of proof as to causal nexus in cases about prospectus liability on the defendant.

The group of persons responsible for a prospectus naturally includes the issuer and the persons listed in the prospectus as being responsible. In addition, it is recognised in Danish case law and legal literature that it is not in itself decisive who is formally held out to be responsible for the prospectus. The crucial question is whether that person has in fact taken

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5 MAR Articles 8 and 14.
6 MAR Articles 10 and 14.
7 MAR Articles 12 and 15.
8 MAR Articles 7 and 17.
9 The Capital Markets Act, Sections 12(1) and 247.
10 MAR Article 18.
part in the offering phase or in the drafting of the prospectus. Consequently, based on an assessment of the circumstances in each individual case, the person who takes part in the offering phase as a member of management, investment bank, accountant, lawyer, adviser, owner, etc. may incur liability.

**Liability for other published information**

MAR, which entered into force in Denmark on 3 July 2016, and the Capital Markets Act (formerly the Securities Trading Act) provide the causes of action for investors seeking recovery of losses suffered as a result of reliance on published information (other than a prospectus), or where published information has been delayed without justification.

Pursuant to MAR Article 17(1), an issuer of securities must inform the public as soon as possible of inside information that directly concerns that issuer. Article 7 defines inside information as information:

- **a** of a precise nature;
- **b** that has not been made public;
- **c** that directly or indirectly concerns the issuer; and
- **d** that if it were made public would be likely to have a significant effect on the prices of the financial instruments.

An intermediate step in a protracted process is deemed to be inside information; see MAR Article 7(3).

MAR Article 17(1) introduced a significant change in Danish law, as it replaced the ‘reality principle’ set out in the then applicable Section 27 of the Securities Trading Act, according to which an issuer was only required to disclose information upon the coming into existence of the relevant circumstance or the occurrence of the relevant event. Thus, under the former rule, inside information about, for example, ongoing negotiations in connection with an acquisition was only to be disclosed when the negotiations led to an actual result. Under MAR, an issuer may instead, in such cases, make use of the possibility of delaying disclosure in MAR Article 17(4).

Pursuant to MAR Article 17(4), an issuer may, on its own responsibility, delay disclosure of inside information, if:

- **a** immediate disclosure is likely to prejudice the legitimate interests of the issuer or emission allowance market participant;
- **b** delay of disclosure is not likely to mislead the public; and
- **c** the issuer or emission allowance market participant is able to ensure the confidentiality of that information.

The Danish FSA must be informed immediately after the disclosure of inside information when the disclosure has been delayed, and the issuer must give the Danish FSA a written explanation of how the requirements of delay were met. The issuer should make sure it is able to document its fulfilment of the requirements during the entire period in which the disclosure was delayed.

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ii Procedure

In Denmark, the procedure in relation to securities actions is set out in the AJA, which governs all aspects of both civil (third book) and criminal (fourth book) proceedings.

Civil court proceedings in Denmark are divided into two stages: written pretrial preparation; and trial hearing in court.

Proceedings are commenced by the filing of a writ of summons. Since 2 February 2018, all civil cases, including Supreme Court cases, are instituted and processed using a digital portal made available by the courts.

Subsequently, the defendant files a statement of defence before a date determined by the court. After having received the statement of defence, the court will arrange for a pretrial hearing, which will usually be held as a telephone conference. At this point, the parties will be expected to agree on a timeline for the remaining case preparation and, if possible, set a trial date. In complex cases, there will usually be a need for further exchange of pleadings and possibly expert reports before the trial hearing.

The pretrial process outlines the scope of the case. If a party wishes to expand the claim, to make new submissions or to produce new evidence after the pretrial process, this may only be done with the permission of the court. There is no general obligation of disclosure or discovery as known in common law jurisdictions. However, upon request from a party and in limited circumstances, the court may order a party or a third party to produce specific evidence, such as documents.

The trial hearing is conducted orally. As a general rule, depositions are not used under Danish law. A party intending to rely on a witness statement must, therefore, call the witness before the court.

The costs connected with a civil action in Denmark are:

\[ \begin{align*}
  a & \quad \text{court fees;} \\
  b & \quad \text{litigation costs, including, inter alia, witness compensation and expenses for expert opinions and translations; and} \\
  c & \quad \text{costs for legal counsel.}
\end{align*} \]

Pursuant to the general rule in AJA, Section 312, the unsuccessful party must compensate the prevailing party for the costs incurred as a result of the action. However, such reimbursement is determined by the court and generally only covers part of the actual costs incurred. Litigants must, therefore, typically be prepared to pay a significant part of their own legal costs, including when succeeding in their claim.

Since 2008, Danish procedural law has allowed group litigation, which is commonly used by investors seeking recovery of losses.

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15 AJA, Section 348.
16 https://www.minretssag.dk/frontpage.
17 AJA, Sections 148a–148b.
18 AJA, Section 353.
19 AJA, Section 358.
20 AJA, Section 298.
21 AJA, Section 254a.
iii Settlements

As in other jurisdictions, parties to Danish court proceedings have a duty to examine the possibilities for a settlement.\textsuperscript{22} The parties can choose to settle at any point during the case proceedings by entering into a settlement agreement. The parties may decide to have the settlement confirmed by the court by way of a court settlement, which is entered in the court records and is enforceable without further formality.

iv Damages and remedies

Under the general law of damages in Denmark, an investor is entitled to be compensated in full so that the investor is restored to the position in which the investor would have been had the purchase of shares not taken place.

Damages are calculated based on the following three fundamental principles:

\begin{itemize}
  \item[a] a principle of restitution, meaning that the injured party is to be fully compensated for his or her loss;
  \item[b] the injured party should obtain no enrichment from the damages; and
  \item[c] the injured party has a duty to mitigate his or her loss.\textsuperscript{23}
\end{itemize}

Danish law does not allow punitive damages or compensation without actual loss except for particular statutory provisions.

III PUBLIC ENFORCEMENT

i Forms of action

The Danish FSA has extensive supervisory powers, which include authorisation and supervision of financial companies, carrying out on-site inspections and overall monitoring of financial companies’ compliance with the capital markets regulation.

An investigation by the Danish FSA often starts with the Danish FSA sending a consultation letter to the financial company with a view to uncovering relevant facts. Ultimately, an investigation by the Danish FSA may result in the Danish FSA issuing an order or reprimand, but the case may also be closed, either after consultation with the financial company or with some criticism of the company. At other times, the violation is so serious that the Danish FSA files a police report.

As a general rule, the Danish FSA is obligated to publish its decisions.\textsuperscript{24} Police reports are an exception as they are often confidential due to the ongoing investigation. Both private and public enforcement of securities claims will often be influenced by any initial inquiries, orders or reprimands of the Danish FSA.

The Danish FSA prepares statistics of market abuse cases. The Danish FSA statistics in the tables below outline, as examples, violation of prospectus regulation and unlawful disclosure of inside information.\textsuperscript{25}

\begin{flushleft}
\textsuperscript{22} AJA, Section 336a.


\textsuperscript{24} The Capital Markets Act, Section 234. Subject to limitations in the Capital Markets Act, Sections 237–239.

\end{flushleft}
Violation of prospectus regulation

<table>
<thead>
<tr>
<th>Year</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
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<td>18</td>
<td>3</td>
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<td>1</td>
</tr>
<tr>
<td>Reprimands and orders</td>
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<td>3</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Police reports forwarded to the public prosecutor*</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>

* Several police reports may be included in one case

Unlawful disclosure of inside information

<table>
<thead>
<tr>
<th>Year</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
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<td>7</td>
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<tr>
<td>Reprimands and orders</td>
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<td>1</td>
<td>4</td>
<td>10</td>
<td>3</td>
</tr>
<tr>
<td>Administrative fines</td>
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<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Police reports forwarded to the public prosecutor</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
</tbody>
</table>

Nasdaq Copenhagen supervises and imposes sanctions for violations of its rule books.

**ii Procedure**

When the police have completed an investigation, the Prosecution Service will decide whether or not to bring formal charges, which depends on whether there is sufficient evidence to convict the provisionally charged person. When formal charges are brought, the case is sent to the court along with an indictment listing the charges.

In Denmark, a case concerned with serious economic crime (e.g., proceedings regarding non-compliance with securities regulation), is, as a general rule, processed according to the same rules as any other criminal case. Therefore, the differences between Danish civil and criminal securities proceedings are worthy of notice.

In criminal proceedings, counsel for the defence may, before the trial hearing, request the police to conduct investigative actions that the defence finds relevant: for example, questioning of witnesses or technical analyses. However, if the police do not find such investigative actions relevant to the case, it will be for the court to decide whether or not to allow the request.

As a general rule, counsel for the defence has a right to receive all case material gathered by the police. The person charged is allowed to review the material, but may only receive a copy with the police’s permission.

In criminal proceedings, there is no written pretrial preparation as in civil proceedings. Although it is allowed to do so, the defence is not expected to produce any written submissions.

For these reasons, the procedural features of criminal securities actions differ significantly from civil securities actions, which, inter alia, usually involve a long exchange of written pleadings. Critics suggest that Danish criminal procedure is, to some extent, inept in its processing of comprehensive cases against financial companies about non-compliance with securities law.

**iii Settlements**

When initiating an investigation, the Danish FSA will typically enter into a dialogue with the financial company subject to investigation, and the company will be given the opportunity to disclose relevant information. Neither settlements in criminal proceedings nor settlements of administrative actions are possible under Danish law.
iv  **Sentencing and liability**

Pursuant to Sections 247 and 249(1) of the Capital Markets Act, non-compliance with Section 12(1) of the Capital Markets Act (prospectus requirements) or MAR Articles 17 (disclosure rules) and 18 (insider lists) is punishable by fine. Non-compliance with MAR Articles 14 (prohibition of insider trading and of unlawful disclosure of inside information) and 15 (prohibition of market manipulation) is punishable by a fine or imprisonment for up to one year and six months; see Section 249(2) of the Capital Markets Act. The standard scale of fines is low compared to international standards.

IV  **CROSS-BORDER ISSUES**

A defendant may be sued in Denmark if the AJA provides the Danish courts with jurisdiction. According to the main rule in AJA, Section 235, proceedings may be initiated in the defendant’s home court. For companies, associations and private institutions, the home court is the court for the judicial district in which the main office is located. If a main office cannot be located, the home court is the judicial district in which one of the members of management or of the board of directors is resident. Legal proceedings involving a claim for non-contractual damages may be instituted in the court for the judicial district in which the legal wrong was committed.

If the defendant is domiciled in an EU Member State, jurisdiction is determined in accordance with the Brussels I Regulation. With few exceptions, for example, consumer contract cases and the rules on exclusive jurisdiction, the courts of the Member State in which the defendant is domiciled will have jurisdiction according to the main rule in Article 4(1) of the Brussels I Regulation. Special rules of supplementary jurisdiction apply in matters relating to contractual relationships, tort or a branch, agency or other establishment.

Finally, if the defendant is not domiciled in an EU Member State, exceptional jurisdictions may apply. Under AJA, Section 246(3), proceedings may be brought before the Danish courts if the defendant held assets in Denmark at the time when the proceedings were instituted. In principle, this includes any asset of financial value, for example, a negotiable document or a counterclaim, which can be established with some certainty.

V  **YEAR IN REVIEW**

The entry into force of the Capital Markets Act on 3 January 2018 is the most significant statutory initiative within Danish securities law since the implementation of the ‘Stock Market Reform II’ in 1995. The actual consequences of this change of law as well as the

26 AJA, Section 238.
27 AJA, Section 243.
29 Ibid., Articles 17–18.
30 Ibid., Article 24.
31 Ibid., Article 7(1).
32 Ibid., Article 7(2).
33 Ibid., Article 7(5).

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changes described in Section II.i as a result of MAR, which entered into force on 3 July 2016, are only beginning to be tested, and Danish legal practitioners are observing developments closely.

As is also evident from the statistics mentioned in Section III.i, one report on violation of prospectus rules was forwarded to the Danish police in 2019. This was a police report of 16 August 2019 filed by the Danish FSA against a Danish big data software company of the Fastbase Group and two other companies of the same group. Without an approved prospectus, the Danish company had offered shares in the company Fastbase Inc. to investors on its website and by contacting potential investors directly by email. The Danish FSA estimated that the offering was in excess of €8 million and that, by announcing the offering on its website, the company had catered to an indefinite number of people (and thereby the offering had been available to more than 150 natural or legal persons). In consequence, the company was not exempted from the obligation to publish a prospectus, according to Section 10(2) of the Capital Markets Act, and this resulted in the police report.

In the field of sports, the Danish FSA issued a reprimand on 6 February 2020 to the Danish football club Aarhus Gymnastikforening A/S (AGF) for not having disclosed inside information, as required under MAR Article 17(1). At the end of June 2019, after various negotiations with F.C. Köbenhavn A/S (FCK) concerning the sale of a player from AGF, the parties had agreed on a transfer agreement, which was conditional on approval by AGF’s board of directors. AGF’s board of directors approved the sale on 1 July 2019, and AGF then disclosed the information to the market. Before the Danish FSA, AGF argued that the information did not constitute inside information until after approval by the board of directors, because the transfer agreement had depended on board approval and it was far from certain that the board would approve the sale. In its decision, the Danish FSA noted, as also explained in Section II.i, that a financial company is not only required to disclose information upon the occurrence of the relevant event, but the decisive factor is whether there is a real possibility of the event occurring. Placing emphasis on the successful sales negotiations and the fact that the parties had agreed on the terms for the transfer agreement, the Danish FSA found that, as of 27 June 2019, inside information had existed.

In another case of inside information, the Danish FSA reprimanded the Danish bank, Sydbank A/S, on 26 August 2019 for not having disclosed inside information as soon as possible, as required under MAR Article 17(1), in relation to a profits downgrade. The Danish FSA established that, on 21 October 2018, the bank’s CFO had shared an interim report with the CEO and indicated the potential need for a downgrade with respect to the full year. According to the Danish FSA, internal discussions then followed, but Sydbank did not assess whether inside information existed until 29 October 2018. The profits downgrade was published by Sydbank on 31 October 2018, when the bank lowered its expectations of its profit after tax for the full year of 2018 from the range 1,340–1,540 million kroner to the range 1,250–1,325 million kroner, which led to a decline in the bank’s share price of 12.7% on the day. With respect to the profits downgrade, Sydbank argued that the bank had not expected the downgrade to noticeably impact the share price, as the downgrade, based on the average of available market analyses, was in line with market expectations. It was only later that Sydbank had found that its estimates had been incorrect. Considering the information presented by the CFO on 21 October 2018, the Danish FSA found that the profits downgrade could have been reasonably expected at this time. Also taking into account that the case concerned a profits downgrade of 14%, the Danish FSA found Sydbank to be in breach of MAR Article 17(1). In its decision, the Danish FSA noted that, while it is not

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a requirement for inside information that the company’s share price is noticeably affected by the information (in this case, the profits warning), an actual impact on the share performance may impact the assessment of whether inside information existed.

Within the private enforcement area, attention has remained, throughout 2019, on the number of actions involving the former Danish company OW Bunker A/S, which was once one of the world’s largest traders of bunker oil. At the public offering in March 2014, OW Bunker earned a market capitalisation of approximately 5.3 billion kroner, but the company filed for bankruptcy in November the same year after suffering risk management losses (approximately US$150 million) and credit losses in a Singapore-based subsidiary (approximately US$125 million).

Currently, there is a bundle of pending private enforcement actions relating to OW Bunker that have been initiated by:

a a consortium of Danish institutional investors pursuing, in two separate actions, claims for prospectus liability (the Prospectus Liability case) and for violation of disclosure requirements;

b a consortium of Danish private investors (Foreningen OW Bunker-Investor) (in October 2018, the consortium was granted free legal aid under the rules in AJA, Part 31, meaning that the legal proceedings will be financed by the Danish government);

c a consortium of primarily foreign institutional investors led by the Deminor Group; and

d the bankruptcy estate itself.

According to media reports on 2 April 2020, another case has been added to the bundle, as the former owner of OW Bunker (the private equity fund Altor) and former members of OW Bunker’s management have filed a lawsuit against Deloitte in Singapore, which was the accounting firm of OW Bunker’s Singapore-based subsidiary.

In the Prospectus Liability case, institutional investors are claiming damages of 767 million kroner in compensation for losses suffered as a result of the investment in shares in OW Bunker in connection with the initial public offering (IPO). The plaintiffs mainly argue that the OW Bunker Offering Circular of 18 March 2014 suffered from material defects as it provided incorrect, incomplete and misleading information and omitted information, primarily about the company’s speculation in oil price changes and the trading activity between OW Bunker’s Singapore-based subsidiary and its customer. The 22 defendants in the Prospectus Liability case include the bankruptcy estate, the board of directors, the day-to-day management, the ultimate owner and private equity fund, and, as of November 2017, also two of the four investment banks organising the IPO. The parties to the case come from, inter alia, Denmark, Luxembourg, Sweden, Guernsey and England.

Owing to their fundamental nature, all of the pending OW Bunker cases, with the exception of the lawsuit against Deloitte in Singapore, have been referred from a district court to the Eastern High Court in the first instance. Interestingly, the Eastern High Court has directed, in accordance with AJA, Section 254, that all of the OW Bunker cases pending before the High Court are to be heard jointly. This is likely to impact the processing of the cases, as the cases will now be tried at one joint trial hearing. This naturally has certain advantages, but is also likely to result in a number of practical challenges considering the high number of plaintiffs, defendants and lawyers, as well as the differences in applicable areas of law.
Adding to the procedural complexity of the *OW Bunker* cases is a recent development with respect to the legal actions filed by the OW Bunker bankruptcy estate. In December 2016, the bankruptcy estate filed its first legal action claiming damages for 400 million kroner, which partly covered a claim for recovery of paid dividends and partly a claim for damages. In October 2017, the bankruptcy estate filed two additional legal actions concerning the same matters and against the same defendants whereby it raised its total claim by approximately 1.8 billion kroner (raising the total claim to approximately 2.2 billion kroner). The additional two legal actions were made possible by way of a litigation funding agreement between the bankruptcy estate and a hedge fund. This prompted the defendants to argue for a dismissal, as the new legal actions, according to the defendants, concerned identical proceedings. At a preliminary hearing in August 2019, the Eastern High Court, under AJA, Section 253(1), cf. (2), listed the issue with respect to the third legal action for a separate trial, and on 31 March 2020 the Eastern High Court ruled in favour of a dismissal by applying a strict lis pendens rule.

Moving on from the *OW Bunker* cases, there has also been a great deal of other activity before the Danish courts within the area of securities law in 2019.

Following the bankruptcy of Amagerbanken A/S in 2011, a former shareholder commenced proceedings against the bankruptcy estate, claiming that a prospectus in relation to an issue of shares in 2010 had suffered from material defects. The question in the case was whether information on an assessment made by Finansiel Stabilitet (an independent public company owned by the Danish state) as to the bank’s impairment needs should have been included in the prospectus. The case had links to another lawsuit on the overall question of liability on behalf of the management for the bank’s collapse (which was finally decided by the Eastern High Court in its judgment of 26 June 2019, according to which eight former members of management were ordered to pay 225.5 million kroner in damages). The prospectus case was first tried in the Maritime and Commercial High Court, which on 21 December 2016 had ruled in favour of the bankruptcy estate, and on 9 May 2019 the Eastern High Court upheld the judgment. In its judgment, the Eastern High Court placed emphasis on the division of competence between the Danish FSA and Finansiel Stabilitet. Taking into account that the Danish FSA was the competent authority in matters concerning solvency and impairment needs of banks, the High Court found that the information from Finansiel Stabilitet did not have such a nature that it should have been mentioned in the prospectus.

At the beginning of 2019, a number of Danish and international investors filed class actions against Danske Bank and certain individuals for the purpose of seeking damages for share price declines and violation of disclosure requirements following the money laundering case relating to the bank’s Estonian branch. Four class actions have been initiated before the Danish courts, and one civil action has been commenced in the United States. These cases are still at a very preliminary stage.

Another case that has attracted considerable attention has been the civil litigation brought by the bankruptcy estate of the former Danish lighting company Hesalight A/S against the founder and CEO, three former members of the company’s board of directors and the company’s accountant. The bankruptcy estate claimed damages for a total of 200 million kroner, as it argued that the defendants had neglected their duties and responsibilities as members of management and as an accountant, respectively, inter alia, in relation to dissipation of a 562 million kroner investment in corporate bonds from six institutional investors and by presenting incorrect financial information in the company’s annual accounts.
In its judgment of 31 March 2020, the district court of Roskilde found the former CEO, two of the former members of the board of directors and the accountant jointly liable to pay damages in the amount of 200 million kroner. The court found that the fact that the investors had not performed their own due diligence before investing in Hesalight did not exclude civil liability, as the management had known that the institutional investors had relied upon the information in the company’s annual accounts, including the information that the annual accounts were confirmed by a state-authorised public accountant. At the time of writing, the judgment was appealed to be tried in the High Court in the second instance.

Two days later, on 2 April 2020, the Eastern High Court upheld the seven-year prison sentence against the founder and CEO of Hesalight passed by the district court of Roskilde on 24 January 2019. The founder and former CEO had been charged with five counts under the Danish Criminal Code, including fraud of a particularly aggravating nature, according to Section 279, cf. Section 286(2), of the Danish Criminal Code, by having presented incorrect information about the company’s past and future earnings, volume of orders, risk management and general financial position to the six institutional investors who had placed the 562 million kroner investment.

VI OUTLOOK AND CONCLUSIONS

The OW Bunker cases described in Section V are likely to be finally tried and decided by the Danish Supreme Court and will make for landmark decisions in that they deal with relatively untested areas of securities law and also raise significant procedural questions. The prospectus liability cases will test the requirements for and the balance between the business description and risk factors in a prospectus, together with the significance of the pre-IPO process. The outcome of the cases will also have an impact on future litigation about the potential liability of investment banks in connection with public offerings. Although the written pretrial preparations are drawing nearer to a close, trial dates for the joint oral hearing have not yet been set.

With respect to the legal actions filed by the OW Bunker bankruptcy estate (see Section V), all parties involved are expected to closely observe whether the High Court decision of dismissal will be appealed to the Supreme Court. In its decision, the High Court noted that general principles of force of law and finality, as well as general considerations of costs and efficiency, cited in the Supreme Court ruling in UfR 2010.1431, indicate that a plaintiff should, as a general rule, include all due claims for damages in the same legal action case. The High Court did not attach significance to the fact that the external funding had only been made available after the commencement of the first legal action, nor to the fact that the cases in question are heard and decided together (and together also with the other OW Bunker cases pending before the High Court), (1) the risk of irreconcilable judgments is eliminated, and (2) it will be possible for the defendants to defend themselves against all claims at once, thus avoiding duplication of work and saving costs. If the High Court decision stands, it leaves the question as to whether the bankruptcy estate will instead seek to raise its claims in its other pending legal action (although this, from reading the case description in the High Court decision, would seem to go against the terms of the external funding agreement).

34 Reported in the Danish Weekly Law Reports for 2010 – UfR 2010.1431 H.
As our thoughts were turning to spring, a different kind of challenge emerged with the constantly unravelling news of the covid-19 outbreak and the different national response initiatives. As of April 2020, the covid-19 developments have led to a highly volatile and turbulent Danish market. One example of this is the suspension of trade in some listed Danish funds of funds.

While, for obvious reasons, it is not yet possible to assess the legal implications of the global covid-19 crisis, all financial market participants are forced to put efforts into establishing how to navigate the new market conditions and must be ready to apply contingency plans. With respect to financial companies’ disclosure obligations, the Danish FSA issued a statement on 20 March 2020 that the outbreak of covid-19 may result in the need for suspension of financial expectations and issuance of profit downgrades among issuers. According to the Danish FSA, such suspensions and downgrades of already announced expectations will generally constitute inside information; thus the Danish FSA stated that issuers are expected to inform the market accordingly (i.e., as soon as possible after issuers become aware of the need to suspend or downgrade their financial expectations for the 2019 year-end result). The Danish FSA noted that this also applies before final figures are available.35 Adding to this, the European Securities and Markets Authority recommends that issuers provide transparency on the actual and potential impacts of covid-19 to the extent possible based on both qualitative and quantitative assessments of their business activities, financial situation and economic performance in their 2019 year-end financial report if these have not yet been finalised, or otherwise in their interim financial reporting disclosures.36

I  OVERVIEW

i  Sources of law

England and Wales follow and, indeed, developed the modern common law system, in which the law is derived from a combination of legislation passed by, or under, government statutes and a system of precedent, whereby decisions of the courts are binding in future cases. In more recent times, the jurisdiction's membership of the European Union (EU) has led to an increasing number of laws passed by the European Parliament being either directly enforceable in English courts, or indirectly incorporated into the legal system through new or amended statutes. The directly enforceable Market Abuse Regulation (MAR), together with its implementing measures, is particularly relevant to securities litigation in the jurisdiction, as it contains the principal legal requirements governing the United Kingdom’s (UK) civil market abuse regime.

The European Union (Withdrawal) Act 2018 EUWA (as amended by the European Union (Withdrawal Agreement) Act 2020) (EUWA) provides that EU legislation that is directly applicable, such as MAR, will form part of UK law at the end of the transition period and gives powers to the government to amend this legislation so that it operates effectively after Brexit (a process sometimes referred to as 'onshoring').

The statutory instrument that will make the onshoring amendments to MAR is the Market Abuse (Amendment) (EU Exit) Regulations (SI 2019/310) (MAR EU Exit Regulations). The explanatory memorandum to the MAR EU Exit Regulations explains that this statutory instrument does not alter the policy approach of the current market abuse regime. Rather, it makes certain amendments to reflect the UK's new position outside the EU and to smooth the transition to this. Up until the end of the transition period, however, MAR continues to be directly enforceable in the UK.

The most relevant statute in the context of securities litigation is the Financial Services and Markets Act 2000 (FSMA), which governs many aspects of the provision of financial services and the operation of securities markets in the UK, including England and Wales and, together with common law claims, provides the main causes of action for investors seeking recovery of losses suffered as a result of investments in applicable securities. FSMA makes

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1 Harry Edwards is a partner and Jon Ford is a senior associate at Herbert Smith Freehills LLP. The authors would like to acknowledge the assistance of Ceri Morgan in producing this edition of the chapter.
2 2014/596/EU.
3 MAR has been directly applicable in the UK (and other Member States of the EU) since 3 July 2016; it replaced most of the national legislation under Part 8 FSMA, that formerly governed the civil market abuse regime, and the disclosure requirements for listed issuers made under Part 6 FSMA.
certain, largely procedural, accommodations to cater for the differences in the governmental and legal systems in England and Wales on the one hand, and Scotland and Northern Ireland on the other. There are, of course, other statutes relevant in more specific instances, which are described later in this chapter.

In addition to creating civil and criminal obligations, FSMA provides the legal basis for the powers and existence of the Financial Conduct Authority (FCA), which, under those powers, develops and maintains a detailed Handbook containing both binding rules and official guidance on the interpretation of those rules.

The FCA also issues ‘soft guidance’ in a number of forms, which do not have official standing, but nonetheless seek to influence the behaviour of those at whom it is aimed by setting out the FCA’s view on a particular issue.

ii Regulatory authorities

The FCA has primary responsibility for regulating the conduct of the UK’s financial services industry and markets. It has the power to take disciplinary action against firms it has authorised to operate in that industry and individuals it has approved to perform certain licensed functions, specified by FSMA. The FCA can bring civil and, in some cases, criminal enforcement action against those whose conduct has breached its rules or statutory requirements, as well as apply to court for specific remedies, such as injunctions.

There are other prosecution authorities with the power to investigate and prosecute criminal offences of market misconduct, the most relevant being:

- the Secretary of State for Business, Energy and Industrial Strategy;
- the Director of the Serious Fraud Office (SFO); and
- the Crown Prosecution Service.

It is these prosecution authorities, rather than the FCA, that have the power to bring criminal prosecutions in respect of criminal fraud or offences under the Theft Act 1968.

iii Common securities claims

Typical public securities actions include insider dealing and market abuse cases (under both the criminal and civil regimes), usually brought by the FCA, and administrative action by the FCA for breaches of the applicable regulatory regime regarding the content of publications made by listed issuers, and for breach of the disclosure requirements under MAR.

Private securities litigation is a growing area in England and Wales. The most common claims that investors in securities have threatened or brought to date are claims under the statutory liability regimes provided for by FSMA and common law claims in fraud or negligent misstatement. The statutory schemes give causes of action for:

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4 Most notably, the prosecution of criminal offences in Scotland remains the responsibility of the Lord Advocate and not the FCA (as is the case in England and Wales).

5 When MAR came into force in July 2016, the bulk of the FCA’s guidance in the Market Conduct Sourcebook and the Disclosure Rules was deleted and replaced by European technical standards, and guidance from the European Securities and Markets Authority (ESMA). Some FCA guidance deemed compatible with MAR has been retained. If additional clarification is required, this will mainly be provided by ESMA, although the FCA retains powers to provide clarification on MAR where necessary.

6 The Prudential Regulation Authority also has power to bring administrative enforcement actions, but with the objective of promoting the safety and soundness of the firms it regulates.
a untrue or misleading statements in prospectuses or listing particulars and the omission of necessary information from such documents (Section 90 claims); and
b recklessly untrue or misleading statements, dishonest omissions of required information, or dishonest delay of such information in relation to an issuer’s other publications (Section 90A claims).

II PRIVATE ENFORCEMENT

i Forms of action

Liability for statements in prospectuses or listing particulars (Section 90 FSMA)

Section 90 FSMA provides a cause of action to an investor where a prospectus or listing particulars relating to securities contains any untrue or misleading statement or fails to include information that is required by statute. Section 87A FSMA sets out the principal requirement that the prospectus or listing particulars include the information necessary to enable investors to make an informed assessment of the issuer and the rights attaching to the securities. The applicable fault standard is essentially negligence (albeit with the burden of proof reversed so that it is for the defendants to show that they were not negligent) by virtue of a defence of ‘reasonable belief’ that the contents of the document were complete and accurate. This fault requirement reflects the nature of the documents to which Section 90 applies as intended to encourage the purchase of securities.

The cause of action allows any person who has acquired the securities in question, and suffered a loss as a result of the defect in question, to claim for compensation under Section 90 FSMA against any person responsible for the defective document.

The list of persons responsible for a prospectus or listing particulars naturally encompasses the issuer and (in equity capital markets at least) its directors taking responsibility for the contents, as well as those who accept responsibility in the offering document or who authorise its contents. The breadth of this category means that, while it is clear that issuers and the directors of issuers are the most likely defendants to a Section 90 claim and the point is so far untested in the case law, it is, in theory, possible for a claim also to be brought against a third-party adviser to the issuer (if it can be established that the adviser has accepted responsibility for the contents of the document).

There is considerable debate as to whether the wording of Section 90 is restricted only to the original purchasers of a security, or whether an investor who acquires securities on the secondary market might also have a claim. However, the better view is that, as long as the

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7 An admission document for the purposes of listing on the London junior market, AIM, is outside the scope of Section 90 FSMA.
8 In particular, its assets and liabilities, financial position, profits and loss and prospects. See also Section 80(1) FSMA.
9 The European listing requirements and market practice for wholesale debt issuers is that the corporate vehicle, rather than the directors, takes responsibility for the content of the offering document. However, the breadth of the test for responsibility to bite (if they ‘authorise the contents’) means that even for such deals the directors could potentially also be liable.
10 The Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001/2956 Regulation 6(1) sets out the full list of persons responsible for the contents of listing particulars, and the Prospectus Rules 5.5, contained in the FCA Handbook, set out the full list in respect of a prospectus.
11 It is noteworthy that a predecessor to Section 90 liability (Section 67 of the Companies Act 1985) gave a right of action to ‘those who subscribe for any shares or debentures on the faith of the prospectus’, in
misstatement or omission remains current (i.e., the passage of time, subsequent events or any updated announcements made by the issuer have not rendered the defect in the document stale), the cause of action will extend to a purchaser of securities in the secondary market.12

Although market practitioners might think it obvious, there is no express requirement in the statute that limits claims only to where there are material defects in the prospectus or listing particulars; it merely requires that the document includes ‘necessary’ information. However, the better view is that there must be some ability for the issuer to select the information that is considered to be material to investors for inclusion in the document, not least to avoid deluging investors with immaterial information. In addition to this practical point, it can be argued that a proper interpretation of the Prospectus Directive builds in a materiality component to what is ‘necessary’ information. In an interlocutory hearing in the RBS Rights Issue Litigation, Hildyard J took the view that the ‘necessary information’ test was a limiting concept that was intended to further the investor protection objective by confining the content of the prospectus only to that which was necessary (i.e., indispensable).13 In any event, a Section 90 cause of action is incomplete without the investor establishing causation and loss, which ought to prevent a successful claim for immaterial information defects. Going forwards, the provisions of the Prospectus Regulation (which apply from 21 July 2019) ought to have put the matter beyond doubt by expressly defining the disclosure requirement by reference to ‘necessary information which is material to an investor’.

Although the issue has not been tested, on the face of Section 90 it is not necessary for the claimant to show that he or she relied on the defective prospectus or listing particulars when purchasing the securities. It is, on the drafting of the legislation, the loss suffered by the claimant that must have resulted from the defect, rather than the acquisition of the securities in question and would be consistent with the investor protection philosophy of the regime. This potentially removes one of the significant hurdles that investors face in bringing a claim on behalf of large numbers of investors, given the obvious practical difficulties for claimants in having to show that they each placed reliance on the defect in question when purchasing securities (particularly since many may not even have read the prospectus or listing particulars in full or even at all).

A defendant14 to a Section 90 claim can rely on any of the defences set out in Schedule 10 FSMA, which, broadly speaking, provide that the defendant will not be liable where it reasonably believed the contents of the document to be complete and accurate, reasonably relied upon an expert or official source to verify the accuracy of the content in question or

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12 See J Lightman, *obiter*, in *Possfund Custodian Trustee Ltd v. Diamond* [1996] 1 WLR 1351 at 1360 discussing the equivalent provision in the statute preceding FSMA, Section 166 of the Financial Services Act 1986. He did not expressly determine the issue because the relevant statutory provision had not been brought in effect, but considered that liability owed to ‘any person who has acquired the securities to which the prospectus relates’ did not extend to the secondary market. See also discussion about liability for aftermarket transactions in Competition Law 1998, 19(10), 311–314 and J Payne, ‘Possfund v. Diamond: a reassessment of the common law duty owed to subsequent purchasers who rely on a company prospectus’, JFC 1997, 4(3), 253–254. The *Possfund* decision has not to date been considered or applied in the context of Section 90 FSMA.

13 *RBS Rights Issue Litigation* [2015] EWHC 3433 (Ch), Paragraph 53.

14 There is a potential question over whether or not the Schedule 10 defences are available to the issuer in addition to natural persons. However, the better view is that they are not restricted to natural persons.
took reasonable steps to (or did in fact) cause a correction to be made before the investor acquired the securities. The investor will also fail in its claim if it can be shown that it knew (not merely suspected) that the statement complained of was inaccurate or incomplete. Interesting questions arise as to the steps that will need to be taken to satisfy the Schedule 10 ‘reasonable-belief’ test, the most important of the defences. For example, is it sufficient to ensure that reasonable processes have been followed (primarily by the issuer’s financial and legal advisers and its auditor) in the conduct of due diligence and verification of the contents of the document? How far down the chain of command within the issuer does the investigation need to go for belief to be attributable to the issuer? How easy will it be, often many years after the drafting of the document in question, to explain the key judgments on materiality to the court (particularly in relation to the omission of information) unless the rationale for those decisions was well documented at the time? In relation to omissions, must the defendant establish that he or she was aware of the specific matter in question and reasonably determined that it could be omitted or is it sufficient that he or she reasonably considered the prospectus to be complete (such that there was a reasonable belief that no material omissions existed)? These, and other issues, are likely to be fertile ground to be explored in the first cases brought to trial under Section 90 in which the reasonable belief defence is deployed. It will also be relevant for directors to show the extent of their knowledge and personal executive (or non-executive) responsibilities, potentially raising the prospect of diverging interests between different directors in defending claims.

An investor is entitled in a Section 90 claim to recover its full loss on the securities in question, likely to be calculated by reference to the true value of the securities (i.e., their price had the inaccuracy or omission not been made) against the actual price paid. Critical questions arise, not yet determined by the English courts, about the appropriate method of identifying the true value, and at which point in time that value should be assessed. Moreover, in certain circumstances investors may seek to recover the total purchase price for the securities (less the credit for any value it may achieve upon disposal following discovery of the defect) if it can be shown that it would not have purchased the securities at all (a ‘no transaction’ case). Outside of an IPO context, difficult questions also arise where investors have sold shares prior to the identification of any defect, and whether those sales relate to shares that were purchased following the defective documents or to pre-existing shareholdings. There is also debate as to whether the right to recover loss extends to consequential losses arising from the purchase of those securities, such as the opportunity cost of what the investor might otherwise have purchased had it not purchased the securities in question. However, the better view is that such compensation would not ordinarily be available under Section 90 and an investor would have to bring a claim in the alternative in fraudulent misrepresentation (deceit) to recover damages on that basis.

**Liability for other published information (Section 90A FSMA)**

Section 90A FSMA has a broader application than Section 90, but is in another sense much more narrowly confined. It applies to all publications an issuer makes to the market, or whose availability is announced, through a recognised information service (other than prospectuses and listing particulars, which are subject only to Section 90). It provides a remedy to investors who have suffered loss as a result of reliance when buying, selling or holding securities on such

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15 See, for example, *Meridian Global Funds Management Asia Ltd v. Securities Commission* [1995] 2 AC 500 PC.
information containing an untrue or misleading statement, or where there is an omission of, or a delay in publishing, information that is required. However, the fault standard is significantly higher than for Section 90: the issuer is only liable if a director knew that, or was reckless as to whether, the statement was untrue or misleading, or if they acted dishonestly in omitting or causing a delay to disclosure of a material fact.

As with Section 90, there is no express requirement for the defect in question to be material. However, the information will need to be material for loss to follow. In addition, the cause of action requires each investor to establish that their reliance on the defect was reasonable, which is unlikely to be satisfied in the case of immaterial defects. The need to show reliance, in contrast to Section 90, provides a serious hurdle to bringing a claim, and in actions that have been brought to date, interlocutory judgments have proceeded on the basis that claimants will have to show that they each relied on the published information in question. However, there remains a live issue as to whether reliance must be shown to have been placed on the defective part of the information published or if it is sufficient to show reliance on the published information as a whole. In the absence of any court guidance or established techniques for claimants to use to show reliance other than on an individual basis, it will be interesting to observe any attempts to import methods that have been adopted in other jurisdictions to overcome this challenge.

Section 90 does not prevent claims being brought under common law, albeit that the advantages of the statutory cause of action make them less likely. By contrast, Section 90A does create a safe harbour for issuers, which prevents claims being brought other than under Section 90A (with its high fault standard). However, claims in contract, under the Misrepresentation Act 1967 and common law claims where there has been an assumption of responsibility for the allegedly defective statement, are carved out of that safe harbour.

As with Section 90 claims, there is currently no case law on the appropriate methodology for determining loss under Section 90A, but the difference between the price paid (or received) and the true value of the security in question (or price realised on its sale) is likely to be the appropriate measure, subject to difficult questions of approach to calculating quantum. While the point has yet to be tested, it is not clear what loss any investor might suffer as a result of merely holding shares (rather than transacting).

**Tortious liability**

The existence of a duty of care for the content of published documents will depend on all of the circumstances and the proper boundaries of the law of tort in this area are the subject of much debate and a large body of case law. In broad terms, the investor will need to show that the statement was made (or the information omitted) by someone who has ‘assumed responsibility’ to investors for the content of that statement, and that it is fair, just and reasonable for the court to impose a duty of care in the circumstances. The courts have found that statutory auditors did not assume responsibility to the purchasers of shares in the company they audited, and the directors of a company did not assume responsibility

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17 For example, see the discussion of ‘fraud-on-the-market’ theory in the US chapter of this book and the discussion of indirect, or market-based, causation in the Australian chapter, including the discussion of the judgment in TPT Patrol Pty Ltd v Myer Holdings Limited [2019] FCA 1747.
to existing shareholders in relation to governance actions (such as voting in an extraordinary general meeting (EGM)) by issuing an announcement or prospectus, or by making certain statements during investor calls relating to the transaction in question.\(^\text{19}\) However, the High Court has recently found that an arranging bank assumed responsibility to investors in publicly issued debt securities to ensure that certain transaction documentation had been properly executed.\(^\text{20}\) Directors also owe duties to existing shareholders to exercise reasonable skill and care when providing recommendations on how to act in relation to corporate actions that they propose.\(^\text{21}\) The standard that was found to apply in assessing whether reasonable skill and care was exercised was found, in the *Lloyds/HBOS* litigation, to be whether no reasonably competent director could have made such recommendation.

Civil liability in the tort of deceit (or fraudulent misrepresentation) can arise if the investor can establish that the false information was intended to be acted on and that, when stating it, the defendant knew it was false, or was reckless (i.e., he or she did not care) as to whether or not it was false.\(^\text{22}\) However, a false statement will not be fraudulent if the provider of the statement had an honest belief in its truth at the time it was made.\(^\text{23}\) The burden is therefore great but, if that intention is established, a presumption is raised that the investor relied upon it and the burden will shift to the defendant to show that the investor did not, as well as potentially extending limitation periods. This cause of action also gives the investor the advantage that it will be able to recover all of its consequential losses, rather than merely those that were reasonably foreseeable. However, it is likely to be a matter of evidence whether the investor can establish on the facts what its counterfactual investments would have been.

If a defendant is able to show that he or she reasonably believed an actionable misrepresentation to be true at the time the contract was made, the investor's claim will be for innocent misrepresentation. However, in most circumstances the applicable remedy for innocent misrepresentation will be rescission, not a claim in damages.

**Liability under the Misrepresentation Act 1967**

Negligent misrepresentation is a statutory claim under Section 2(1) of the Misrepresentation Act 1967 that is established when an investor can show that he or she entered into a contract in reliance upon a misleading statement of fact made by or attributable to the defendant. The defendant will be liable if he or she cannot show that he or she reasonably believed the statement to be true at the time the contract was made.\(^\text{24}\) Accordingly, once the statement is shown to have been false, the burden of proving that the statement was made with reasonable belief in its accuracy shifts to the defendant.

The remedies available are favourable to claimants and include both damages, assessed on the measure usually reserved for actions in deceit, and rescission of the relevant contract. However, Section 2(1) only allows for that remedy to be claimed from the contracting counterparty. In a surprising first instance decision in *Taberna Europe CDO II Plc v. Selskabet AFI*,\(^\text{25}\) the court found that Section 2(1) of the Misrepresentation Act could be relied upon


\(^{20}\) Golden Belt 1 Sukuk Company v. BNP Paribas [2017] 3182 (Comm).


\(^{22}\) Derry v. Peek [1889] UKHL 1.


\(^{24}\) Misrepresentation Act 1967, Section 2(1).

\(^{25}\) [2015] EWHC 871 (Comm).
by a secondary market purchaser for a misstatement made by the issuer to the primary purchaser on the basis that the secondary market purchase brought the issuer and purchaser into some kind of contractual relationship, notwithstanding that the misstatement was made in respect of a different contract. However, the Court of Appeal\textsuperscript{26} overturned this decision confirming that, in the event of a misrepresentation made by the issuer, the remedy under the Misrepresentation Act is only likely to be available for subscribing shareholders, rather than those who purchase on the secondary market.

**Company law duties**

Claims might also be brought under company law duties owed to shareholders, such as the duty to provide existing shareholders with sufficient information for them to make a reasonably informed decision about any proposals put to them at EGMs.\textsuperscript{27} The *Lloyds/HBOS litigation* has clarified the scope of this duty, emphasising that the duty requires the company and its directors to provide a fair, candid and reasonable description of the transaction that is being proposed based on the knowledge that the directors in fact had at the time of publication of the document.\textsuperscript{28} It is necessary for the claimants to prove both reliance and causation. For example, the claim failed in the *Lloyds/HBOS litigation* because shareholders could not establish that they relied on the shareholder circular issued by Lloyds (indeed most of the claimants accepted that they had not even read it) and, in any event, it would have made no difference if the information that it was determined should have been disclosed in fact had been. The acquisition of HBOS would still have completed, so the claimants could not establish causation.

However, in the *Lloyds/HBOS litigation*, Norris J made obiter comments that suggest that losses suffered by shareholders as a result of breaches of these company law duties may fall foul of the rules preventing claims for losses that are merely reflective of losses suffered by the company. It remains to be seen if this issue prevents future claims from being successful.

**Breach of regulatory obligations**

FSMA establishes a number of statutory claims available to investors who have suffered loss as a result of a breach of FSMA itself or of rules made by the FCA in addition to claims under Section 90 and Section 90A (referred to above). An investor will have a claim where the investment agreement was made with or through a person who was not authorised by the FCA, but should have been, or where the investment was a result of an unlawful financial promotion.\textsuperscript{29}

\textsuperscript{26} *Taberna Europe CDO II Plc v. Selkahet AFI* [2016] EWCA Civ 1262.

\textsuperscript{27} *Kaye v. Croydon Tramways* [1898] 1 Ch. 358 CA (Civ Div); *Tiesen v. Henderson* [1899] 1 Ch. 861 HC (Ch); *CAS (Nominees) Ltd v. Nottingham Forest FC Plc* [2002] BCC 145 HC (Ch); *Re Smith of Smithfields Ltd* [2003] EWHC 568 (Ch).

\textsuperscript{28} *Sharp v. Blank* [2019] EWHC 3078 (Ch).

\textsuperscript{29} FSMA, Sections 26, 27 and 30.
Under Section 138D FSMA, a private person will have additional claims available where an authorised person has breached eligible provisions of FSMA or the FCA rules and that breach has caused the claimant loss. These claims are most commonly used by a private person where there has been a failure on the part of an authorised adviser to ensure its advice is suitable or where he or she was misled in some way as to the nature or description of the investment.

In the context of securities litigation, the English courts had previously confirmed that a claim under Section 138D FSMA was not available in respect of an alleged breach of the civil market abuse provisions in FSMA or of listing rules made pursuant to Part 6 FSMA. However, with the advent of MAR, which replaced the civil market abuse provisions in FSMA, the position is less clear.

Private parties have, in certain contexts, been able to rely on breach of an EU regulation in civil proceedings. Where a requirement imposed under an EU regulation such as MAR is sufficiently precise or unconditional to be relied on in the national courts, or is capable of creating rights for individuals, then in principle, breach of that requirement may provide an additional legal ground around which to base a claim. It would be necessary to establish a link between the interest on which the person concerned is relying and the protection afforded by the provision in the regulation, and that the person has suffered loss as a result of the breach, and it may also be necessary for that person to avail themselves first of other available rights of recourse.

Claims against issuers for the publication of false, misleading or incomplete information to the market, such as the claim brought by Mr Geltl and others against Daimler, will be confined to relief under Section 90A (and Schedule 10) FSMA. However, claims by counterparties who suffer loss as a result of insider dealing or market manipulation could

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30 Defined in the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2000, Regulation 3 and broadly any individual who is not carrying out a regulated activity, and some corporate entities that are not acting in the course of business, when suffering the loss. See Titan Steel Wheels v. RBS [2010] EWHC 211 (Comm) for the courts’ restrictive approach to the meaning of ‘private persons’ for the purposes of standing to bring a claim under what is now Section 138D FSMA. There is ongoing speculation about changes to primary legislation to broaden the categories of claimants who fall within the scope of Section 138D FSMA.

31 Obligations placed on authorised persons by FSMA or the FCA Rules will be eligible provisions for this purpose unless there is a further provision stating that a breach does not give rise to a claim of this type.


33 See Case C-403/98 Azienda Agricola Monte Arcosu v. Regione Autonoma della Sardegna [2001] ECR I-103 in which the court considered the provisions of a regulation not to be sufficiently precise, and left Member States a residual discretion, and therefore concluded that the provisions could not be directly relied upon.

34 See the Opinion of Advocate General Geelhoed delivered on 13 December 2001 in Case C-254/00 Muñoz v. Fruunar Ltd [2002] ECR I-7289, and also R (on the application of United Road Transport Union) v. Secretary of State for Transport [2013] EWCA Civ 962, in which the Court of Appeal held that the availability of civil proceedings in private law to uphold rights against a competitor did not mean that, in other contexts, and under different regulatory schemes, enforcement may not properly be limited to other means outside the private law. Significantly in that case, the complainant would not himself have suffered any recoverable financial loss, and in the event of unjustifiable inaction on the part of the relevant agency, could have sought judicial review.

35 Following the judgment of the European Court of Justice in Markus Geltl v. Daimler AG [C-19/11], the litigation brought by Mr Geltl and others against Daimler in the Stuttgart Regional Higher Court in respect of loss suffered as a result of delay in announcing inside information about the CEO’s early retirement was resolved through an out-of-court settlement.

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provide a source of litigation. Where loss is suffered by a private person, the FCA (or other prosecutors) may also obtain an order for restitution or compensation for their benefit.\(^{36}\) It is not inconceivable that buy-side parties in receipt of inside information from an issuer or its financial advisers as part of a market sounding, in respect of a transaction for which no cleansing announcement is made, may consider exploring injunctive relief as an option; the FCA also has power to compel issuers to make an announcement.

**ii Procedure**

In England and Wales, the procedural features of a private securities claim are largely governed by the Civil Procedure Rules, which form a procedural code governing all aspects of the conduct of civil court claims, with the overriding objective of dealing with cases justly and at proportionate cost.\(^{37}\)

Claims will be commenced by the claimant filing and serving a claim form, which will be accompanied or followed by detailed particulars of the legal and factual basis for the claim. Assuming the defendant intends to defend the claim and does not dispute the English courts’ jurisdiction, it will file and serve a defence, setting out in detail which parts of the claim it admits, those it denies and those it requires the claimant to prove.\(^ {38}\) While the court has wide discretion to determine the subsequent conduct of the claim, the parties are then typically required to give extensive disclosure of documents, including, in particular, those documents that undermine their case or support another party’s case, and to exchange witness statements of those individuals each party intends to call to give evidence at trial. Factual witness evidence will often be supplemented by expert evidence on issues that the court permits to assist it in the assessment of the issues in dispute. The court has substantial discretion to order the trial to be on all of the issues at once, or to order a trial of certain preliminary issues or a split trial (which may involve, for example, liability and quantum issues being determined at separate trials).

There is no true concept of a securities class action in England and Wales in the sense of a representative, opt-out action that is familiar in other jurisdictions. Where multiple claims against the same defendants raise common legal or factual issues, there are, however, three broad mechanisms by which those claims might be joined together. The first and most common is where the claimants themselves successfully apply for a group litigation order, with the effect that the court will manage their claims substantially as one. This is the procedure most similar to class actions in the securities litigation context. However, the critical point is that it is an opt-in regime, and a sufficient number of claimants will need to be persuaded to bring claims and join the group to make a claim financially viable (or to attract third-party funding). The consequent need for a ‘book-build’ at the commencement of proceedings tends to lead to a front-loading of costs for claimants and their funders. Secondly, the court could exercise its case-management powers to order that the claims are consolidated, or thirdly, it could order that a number of claims that it considers raise common issues are suspended and an individual case, or a small number of cases, be decided as test cases before that suspension is lifted. Whichever of these processes is followed, given the subject matter and likely scale of

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\(^{36}\) See, e.g., FCA Final Notice of 28 March 2017 in respect of Tesco Plc and Tesco Stores Limited (Tesco).

\(^{37}\) Civil Procedure Rules, Rule 1.1.

\(^{38}\) If a defendant fails to defend a claim within the applicable time limit following valid service, the claimant will be able to apply to court for a default judgment, allowing it to begin the enforcement process.
a piece of securities litigation, the case will usually be eligible for inclusion in the Financial List, which involves the assignment of a docketed judge from a list of judges who specialise in financial litigation.

A key feature of litigating in England and Wales (which might be thought likely to act, to some extent, to temper the growth of securities class action claims) is that, where a party is unsuccessful in bringing a claim, it will generally be required to pay the defendants’ reasonable legal costs. This may extend to any third-party funders who assist in financing an unsuccessful claim. While in practice the costs awarded will not represent the full costs a party has incurred in the litigation, these sums are still usually significant and may act as a deterrent to bringing weak or speculative claims.

iii Settlements

Principally as a result of the opt-in nature of securities litigation in England & Wales, there is no general requirement for judicial oversight of an agreement to settle securities litigation. A settlement agreement will simply be a contract between the claimant and the defendant agreeing the terms upon which the litigation will be discontinued, or indefinitely suspended. That agreement will usually make provision for the apportionment of legal costs involved in the claim. However, there are obvious practical difficulties in settling a claim brought by those investors who have joined the group litigation, at least until the court orders that new claimants cannot join the group (or limitation periods have expired). There are also practical difficulties in coordinating settlement discussions with such a large and potentially diverse set of claimants, potentially with different interests and levels of motivation for the pursuit of their claims. In the event that settlements are achieved with certain parts of the class, practical issues of case management may arise from the fact that different groups of claimants may have taken primary responsibility for certain aspects of the claim, leaving any residual claimants needing to elect to narrow the claim or take on the responsibility for those additional aspects, possibly at short notice prior to trial.

One unusual feature of the jurisdiction, however, is that there is a formal regime in place whereby either party to the litigation can make an offer to settle, which, if the other side refuses to accept but then fails to beat at trial, can reverse the usual rule as to liability for costs.

III PUBLIC ENFORCEMENT

i Forms of action

The FCA has a range of powers to investigate and sanction authorised firms, approved individuals or listed issuers who it suspects have breached FSMA or the FCA’s rules. It also has the power to impose administrative sanctions on any person in respect of a breach of requirements under MAR.40 For the most part, the regulator will have the power to impose sanctions directly where it concludes that a breach has occurred. In those cases, it will issue a decision notice, notifying the firm or individual of its findings and imposing what it considers

39 Civil Procedure Rules, Part 36.
40 The FCA also has power, on an application to the court for an injunction or restitution, to ask the court to impose a penalty in cases of market abuse under Section 129 FSMA – see FCA v. Alexander, FSA/PN/053/2011; FCA v. Da Vinci & Ors [2015] EWHC 2401 (Ch).
to be the appropriate penalty. That decision notice will usually be published. It will then be for the recipient of the decision notice to decide whether it wishes to refer the FCA’s decision to a specialist court known as the Upper Tribunal, which will hear the matter afresh, and determine the appropriate action to be taken by the decision maker (this could include an increase in penalty). The matter is then remitted back to the FCA.

In the context of securities, the key areas that the FCA tends to focus on in its civil enforcement actions include failures in a firm’s governance, systems or controls, breaches of MAR requirements ensuring disclosure and transparency in relation to price-sensitive information, civil market abuse offences, failures to properly advise on investments (where there is a duty to do so) or to comply with conduct of business or financial promotion rules, and individual failings of a firm’s senior managers.

The FCA also has the power to investigate and prosecute certain criminal market misconduct offences, including insider dealing, making a false or misleading statement intended to induce someone to invest in securities, creating a false or misleading impression in relation to relevant markets or securities or in respect of benchmarks. The FCA shares the power to prosecute those offences with other prosecutors including the Secretary of State for Business, Energy and Industrial Strategy, the Director of the SFO and the Crown Prosecution Service.

Those agencies have agreed on broad principles that guide the decision as to which agency should investigate a suspected offence and, where more than one agency is investigating, how they should cooperate to avoid unnecessary duplication and ensure procedural fairness.

The FCA, unlike other prosecutors, does not have the power to prosecute criminal fraud or offences under the Theft Act 1968.

ii Procedure
Where the FCA decides to commence an enforcement investigation, its first step will be to appoint investigators, who will usually be FCA staff. A notice of that appointment and the reasons for it will usually be given to the individual or firm that is the subject of that investigation. There will then follow scoping discussions to determine the likely structure and timescale of the investigation.

FSMA grants the FCA a range of powers to compel the production of documents and information relevant to its investigation (including interviews). It will typically exercise these powers following scoping discussions with the subject of the investigation to gather the information it considers it will need to progress the investigation. However, the FCA may not compel the production of legally privileged documents.

41 Criminal Justice Act 1993, Part V.
42 Financial Services Act 2012, Section 89.
43 Financial Services Act 2012, Section 90.
44 Financial Services Act 2012, Section 91.
45 The FCA and the Crown Office have agreed arrangements for the prosecution of offences in Scotland arising out of FCA investigations.
46 In addition, Section 166 FSMA gives the FCA the power to appoint a skilled person to produce a report, on which enforcement action is commonly based.
47 Sections 122A–122F in respect of breaches of MAR, and Sections 170–176A FSMA generally.
48 Defined as ‘protected items’ as described in Section 413 FSMA.
In criminal market misconduct investigations, the FCA may, as an alternative to compelling document production, obtain a search warrant from the court to enter and search premises (with a police officer) for the purposes of obtaining relevant documents.\(^{49}\)

Typically, the FCA will conduct interviews after gathering relevant documents. It may use powers granted to it under FSMA to compel relevant persons to attend interviews. In the context of criminal market conduct investigations it may, however, choose to conduct voluntary interviews under caution, so that what is said in the interview will be admissible as evidence in a criminal court.\(^{50}\)

Once it has concluded that it has sufficient grounds to make a finding against the firm or person being investigated, the FCA will, in administrative cases, issue a warning notice, setting out the contraventions it considers to have occurred and the proposed penalty. It has the power to publish that notice.\(^{51}\) The recipient of the warning notice will have an opportunity to make representations on its contents before the regulator finalises its decision in a decision notice.\(^{52}\) This will be done by the Regulatory Decisions Committee, which is an independent function within the FCA. The findings set out in the decision notice can be challenged by referring the matter to the Upper Tribunal for a fresh hearing of the facts and law,\(^{53}\) or seeking judicial review by the courts of some flawed aspect of the FCA’s process on narrow, public law grounds.\(^{54}\)

In market conduct proceedings, where the FCA determines that a criminal penalty is warranted, it will prosecute the offence through the criminal courts in the same manner as any other applicable prosecutor.

iii Settlements

The overwhelming majority of FCA administrative actions against authorised firms and listed issuers are settled at an early stage. Firms are typically incentivised to do so by factors such as reputational concerns, management time and distraction and the availability of a discount of up to 30 per cent on the financial penalty.\(^{55}\) Individuals being investigated will be facing potential loss of their livelihood by being banned from regulated positions, or a substantial fine, and may well be less incentivised by such factors (and indeed may opt to fast-track referral of the case to the Upper Tribunal).

There is no judicial oversight of the regulator’s decision to settle a civil or administrative matter, although the FCA must have regard to its statutory objectives when agreeing a settlement. However, the settlement scheme does not apply to civil or criminal proceedings brought in the courts.

As in private actions, the settlement will essentially take the form of a written agreement. As part of that agreement, the individual or firm under investigation will usually agree the

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\(^{49}\) Section 122D (for market abuse) and Section 176 FSMA.

\(^{50}\) Section 174 FSMA.

\(^{51}\) Section 67(1)–(3) FSMA.

\(^{52}\) Section 67(4)–(6) FSMA.

\(^{53}\) Section 67(7) FSMA.

\(^{54}\) But see the Court of Appeal decision in *R (Wilford) v. Financial Services Authority* [2013] EWCA Civ 677.

\(^{55}\) It is now also possible to enter into a focused resolution agreement and in this way partly contest a proposed action (see Decision Procedure and Penalties manual (DEPP) 5.1.8AG to DEPP 5.1.8DG). A discount is also available in respect of partly contested cases – DEPP 6.7.3A.
form of wording that will be included in a public notice, along with the details of the fine or other penalty that will be imposed. Upon reaching a settlement before a decision notice is issued, the person or firm in question will be expected to cover its own legal costs.

In criminal proceedings, a guilty plea will be a mitigating factor in the court’s assessment of an appropriate sentence for a criminal conviction (often meriting up to a 30 per cent reduction in sentence) and a prosecutor retains discretion about the selection of charges that may be brought. The prosecutor may even go so far as to present a recommended sentence to the court. While a prosecutor can decide which charges to bring, it is ultimately for the court to decide what sentence is appropriate in all the circumstances. The courts have in the past expressed displeasure with a prosecutor presenting a recommended sentence as a ‘done deal’.56

The Director of Public Prosecutions and the SFO now have the power to offer deferred prosecution agreements (DPAs) in relation to certain offences and when dealing with corporate defendants.57 For a DPA to come into effect, the court must determine that the DPA is in the interests of justice and its terms are fair, reasonable and proportionate. The use of DPAs in the UK is not yet widespread.58

iv  Sentencing and liability

The FCA has powers to impose a broad range of disciplinary penalties and sanctions. The sanctions most commonly used by the FCA are:

- fines (with no upper limit on the amount);
- a public censure;
- imposing suspensions and restrictions on firms from conducting regulated business and on regulated individuals from carrying out regulated functions; and
- a private warning.

The FCA has articulated a five-step penalty setting process.59 The FCA will usually consider disgorgement of any benefit received as a result of the breach and an additional financial penalty reflecting the seriousness of the breach. An adjustment (upwards or downwards) may also be made to reflect any aggravating and mitigating factors as well as to ensure that the penalty has an appropriate deterrent effect.60

Following the implementation of MAR, the FCA also has the power to prohibit an individual from holding an office or position involving responsibility for taking decisions about the management of an investment firm, and from acquiring or disposing of financial instruments, whether on his or her own account or for a third party.61

In addition to its formal disciplinary powers, the FCA also has the ability to impose other sanctions, including banning an individual, suspending an issuer’s securities from

56 See, for example, R v. Innospec Ltd [2010] EW Misc 7 (EWCC) (18 March 2010).
57 Crime and Courts Act 2013, Section 45 and Schedule 17. Although other prosecutors can be designated, this has not as yet occurred.
58 The SFO’s first application for a DPA was granted judicial approval on 30 November 2015 in the case of SFO v. ICBC Standard Bank Plc, a case involving offences under the Bribery Act 2010, not securities litigation.
59 DEPP 5.6, DEPP 5.6A-C. The FCA is planning to consult on revising its penalty process.
60 DEPP 6.5.
61 Section 123A FSMA.
trading, varying or withdrawing a firm’s permission or an individual’s licensed status, and requiring redress or restitution to be paid where consumers have suffered loss as a result of a breach. In addition, the FCA may now require issuers to publish information and other corrective statements.\(^{62}\) Under the umbrella of the legislative implementation of the Markets in Financial Instruments Directive (MiFID), the regulators now have the power to require an investment firm, credit institution or recognised investment exchange to remove a person from the management board if the regulator considers it necessary for the purpose of the exercise by it of functions under MiFID or the Markets in Financial Instruments Regulation.\(^{63}\)

The FCA can also pass evidence to the Department for Business, Energy and Industrial Strategy with a view to enabling director disqualification orders to be sought, or director disqualification undertakings to be accepted, in respect of any individuals involved in certain breaches.

IV CROSS-BORDER ISSUES

i. Private

The critical cross-border question, in the absence of a clear contractual submission to jurisdiction language, is whether the English courts are the appropriate jurisdiction for the claim to be heard. The way in which the courts approach the determination of the complex question of jurisdiction is dependent on whether the common law rules or the EU regime apply to the circumstances of the claim. This question is in turn primarily driven by the domicile of the defendant, in particular whether it is domiciled in the EU or not.

**EU-domiciled defendant – the recast Brussels Regulation**

The general rule is that the defendant should be sued in his or her place of domicile. Accordingly, a claim against an English domiciled issuer (to which Section 90, Section 90A or one of the tortious claims described above may apply) is likely to be capable of being brought before the English courts (subject to the existence of a contradictory exclusive jurisdiction clause in the applicable documentation that is of binding effect). However, there are a number of important exceptions to this rule whereby, even if the defendant is not domiciled in England and Wales, a claim may nevertheless be brought in the English courts (and that issuers in England and Wales could face claims in the courts of other jurisdictions). The most relevant alternative jurisdiction for a tortious claim is the place where the harmful act occurred, which, pursuant to Article 7(2) of the recast Brussels Regulation, means either: (1) where the damage occurred; or (2) where the events giving rise to the damage occurred. While not free from doubt, the location of (2) is likely to be where the document in question was drafted and distributed. However, for (1), the position is subject to greater uncertainty. The decision of the European Court of Justice (ECJ) in *Kolassa*\(^{64}\) suggested that in a prospectus claim the alleged damage occurred in the place of the investor’s bank account from which the investment was made. This was a controversial decision given the potential consequence that jurisdiction of prospectus claims may be both unpredictable and have no

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\(^{62}\) Sections 122G and 122F FSMA.

\(^{63}\) See Part 5 of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017, that also makes provision for the procedure to be followed and the right of referral.

\(^{64}\) *Kolassa v. Barclays Bank Plc* (Case C-375/13).
real link to the matters in dispute. Fortunately, the position has been clarified by the ECJ in *Universal Music*,\(^{65}\) which adopted a more narrow approach to the question of where the damage occurred, emphasising that, when the damage is purely financial, the connection will need to be greater than simply the jurisdiction from where the purchase monies were paid. In a securities litigation context, for example, the place where the prospectus was issued or where the securities are sold into is more likely to be the test following *Universal Music*.

It remains to be seen what the position will be following the UK’s departure from the EU.

### Non-EU domiciled defendant – common law rules

The common law rules on jurisdiction begin with whether the party can be validly served with English proceedings. Where the party is within the jurisdiction, even if only temporarily, the proceedings may be served on that party. However, the English court may grant a stay of those proceedings in the event that the defendant can show that another forum is clearly more appropriate to hear the claim (the principle of *forum non conveniens*).

Where the party is not in the jurisdiction, the court will need to grant permission for the claimant to serve outside the jurisdiction. To obtain permission the claimant will need to satisfy a threefold test:

\(a\) that the claim has a reasonable (i.e., more than fanciful) prospect of success;

\(b\) that there is a good arguable case that the circumstances fall within a number of statutory gateways set out in the relevant procedural rules, such as the damage being sustained within England and Wales or as a result of an act, or breach of contract, committed in England and Wales; and

\(c\) that England and Wales represents a clearly or distinctly appropriate forum in all of the circumstances, such that the court should exercise its discretion to permit service out of the jurisdiction.

### Public

**Jurisdictional reach of the FCA**

The FCA's general conduct and supervisory jurisdiction under FSMA extends to all firms undertaking specified regulated activities in the UK. This will be the case whether they do so in accordance with regulatory permissions obtained in the UK, or in accordance with a 'passporting' arrangement under one of the EU single market directives or the Treaty of Rome,\(^{66}\) which enable firms regulated in other EU jurisdictions to carry out regulated activities in the UK where they meet certain criteria. The passporting arrangements will continue to apply until 31 December 2020 during the transition period, following the UK’s exit from the EU on 31 January 2020.

The FCA’s jurisdiction is generally confined to conduct that occurs in the UK, although certain rules have wider territorial scope (most notably the requirement to disclose issues to the regulator). The nature of international securities transactions also means that there

\(^{65}\) *Universal Music International Holding BV v. Schilling* (CC-12/15).

\(^{66}\) Otherwise known as the Treaty on the Functioning of the European Union.
may often be a practical difficulty in determining whether it can be said that aspects of the transaction have taken place within the UK. The FCA is also empowered to conduct investigations in support of overseas regulators.67

The FCA’s market abuse jurisdiction

By contrast, the FCA must ensure that the provisions of the MAR are applied in the UK, not only in respect of all actions carried out in the UK, but also in respect of actions carried out abroad relating to financial instruments:

- admitted to trading on a regulated market or for which a request for admission to trading on such a market has been made;
- that are traded on a multilateral trading facility (MTF), admitted to trading on an MTF or for which a request for admission to trading has been made on an MTF;
- that are traded on an organised trading facility (OTF); and
- in respect of financial instruments whose price or value depends on or has an effect on the price or value of a financial instrument referred to in points (a) and (b), including, but not limited to, credit default swaps and contracts for difference.

It is expected that actions carried out within the UK would encompass actions carried out in the jurisdiction in respect of any EEA regulated market that is accessible electronically in the UK. It is not unusual for several EEA regulators to have concurrent jurisdiction in respect of the same conduct.68

Jurisdiction of criminal courts

In broad terms, as a matter of common law, the English courts’ criminal jurisdiction extends only to conduct that occurs within England and Wales. However, given the increasing tendency for criminal activity to be of a cross-border nature, modern authorities have tended to interpret this doctrine in a broad manner to encompass cases where a substantial proportion of either the prescribed conduct or, where applicable, the prescribed consequences occur within England and Wales.

There are, however, a number of specific statutory exceptions that explicitly extend the territorial scope of certain offences beyond England and Wales. In the context of criminal conduct in relation to securities, the criminal insider dealing and market manipulation offences are the most obvious examples. In an extension of the more recent approach at common law described above, these offences capture both conduct that occurs within or from England and Wales and conduct that occurs abroad where the likely effect is in England and Wales.69

67 Section 169 FSMA.
68 It is not yet clear what policy decision will be taken about jurisdiction following the UK’s exit from the EU, although it seems likely that the UK will adopt an approach similar to the UK regime that predated the European legislation, which sought to capture behaviour that took place in the UK or in relation to investments traded on a trading venue situated in the UK or that was accessible electronically in the UK.
69 The UK has opted out of the Criminal Sanctions (Market Abuse) Directive 2014/57/EU, Article 10 of which requires Member States to establish jurisdiction (at least) in respect of criminal market abuse offences committed in whole or in part in their territory, or by one of their nationals where the act is an offence where it is committed.
V YEAR IN REVIEW

i Private

The number of actual and prospective cases in which shareholders are seeking redress in the English courts, under the common law or FSMA, continues to grow steadily, and a handful of cases have led to judgments on specific points of interest in relatively untested areas of law.

Judgment in the claim against Lloyds Banking Group and five of the former directors of Lloyds TSB for losses they claim to have suffered as a result of their approval of the acquisition of HBOS and participation in the UK government’s recapitalisation scheme in 2008 was handed down in November 2019.70

As the first case to reach judgment in a securities class action, it is very significant and will be influential on future class actions brought in the jurisdiction.

The claims centred on two broad criticisms of the Lloyds directors’ conduct in the context of the acquisition of HBOS. First, shareholders claimed that the recommendation that they were given to vote in favour of the acquisition at the EGM convened to approve it was negligently made. Had the board acted reasonably, it was alleged, it would have recognised the risks involved in acquiring a bank that was as exposed as HBOS was to the deteriorating economy. Second, the shareholders alleged that they were not told of the true state of HBOS in the shareholder circular which informed their vote. In particular, it was alleged that the directors omitted to disclose that HBOS was in receipt of two specific forms of funding (so-called emergency liquidity assistance or ELA, and a facility from Lloyds itself) that it was using to continue to fund its balance sheet in the context of the liquidity crisis following the collapse of Lehman Brothers.

Both claims were dismissed in their entirety. In relation to the recommendation case, the court found that the decision to recommend the acquisition was a reasonable one, in the context of the work which had been performed to assess both the risks and the opportunities that the combined group would have. While events after completion of the acquisition may lead one to conclude that the transaction had been an error of judgment, that was not sufficient. The temptation to assess the decision with the benefit of hindsight had to be resisted and it could not be said that the decision to recommend the deal was one that no reasonable director could have made.

The disclosure case was also dismissed. The judge approached the question of what shareholders needed to know by focusing on matters that would impact the combined company, rather than matters that would impact only the standalone HBOS (if the acquisition was rejected). He, therefore, endorsed the directors’ approach of ensuring that shareholders understood the position that they would be in if the vote was passed and if it was rejected. However, on balance he determined that the information about HBOS’s sources of funding was information that shareholders ought to have been told about. It would have told them how ‘far along the journey’ HBOS was, even though it was clear to all what the ‘destination’ would have been absent the acquisition.

For the claimants to succeed, though, they needed to establish that those breaches of the information duty caused shareholders to suffer loss. On this, they failed. Needing to show that the acquisition would not have completed had the funding disclosures been made, the claimants put forward three alternatives for what would have happened in the counterfactual:

The directors would have withdrawn the proposed acquisition rather than make the disclosures. The judge rejected this suggestion as inherently unlikely, given the conclusions he had reached about the reasonableness of the recommendation.

The disclosures would have led to the HBOS share price falling in a ‘death spiral’, inevitably leading to the collapse of the deal. The judge concluded that it was not probable that there would have been any such collapse in the HBOS share price so he rejected this counterfactual.

The disclosures would have caused the shareholders to reject the acquisition at the EGM. The judge noted the evidential burden that the claimants faced in establishing that the outcome of the vote would have been different (since 98 per cent of those that voted did so in favour of the deal) and concluded that the claimants had not managed to get close to discharging that burden.

In any event, the claimants would have failed to establish the quantum of loss that they had allegedly suffered. Both parties had used a particular form of expert evidence, known as an event study, to seek to establish the difference between the price of a share in the combined entity on the one hand, and the price of a hypothetical standalone Lloyds share price (which is what shareholders would have retained if their causation case had been proven and the assumption made that the deal had not completed) on the other. The parties agreed that the difference between these figures was an appropriate measure of the loss (if any) that had been suffered. However, the judge rejected the methodology that had been adopted by the claimants’ expert to identify what would have happened to Lloyds’ share price following any of the events that led the deal to fail. Accordingly, the claimants had failed to prove their loss, so would not have been awarded damages in any event.

It is noteworthy that the judge needed to consider the application of the principles most recently considered in the Manchester Building Society v. Grant Thornton UK LLP71 (currently awaiting on appeal to the Supreme Court) relating to whether losses suffered are within the scope of the duty breached. Lloyds argued that, in the event that the disclosure breaches had been found to have caused the acquisition to proceed (i.e., the deal would not have completed but for the breaches), any losses suffered by shareholders were outside the scope of the disclosure duties because they were caused by the impact of the economy on HBOS’s loan portfolios rather than as a result of HBOS’s liquidity issues. In that way, they were analogous to the ‘mountaineer’s knee’ in Lord Hoffmann’s famous example in the SAAMCo case, as losses that, while a foreseeable consequence of the activity in question (in this case, the acquisition of HBOS), were not losses that the directors were assuming responsibility for in making the disclosures. In obiter comments, the judge rejected this analysis, arguing that while the critical distinction remains between information cases (where the provider of information does not guide the whole decision-making process) and advice cases (where the adviser does), the context of the disclosures being made in a document that recommended the acquisition meant that no bright-line distinction could be drawn. This analysis, if followed in future cases, may have a significant impact on the extent of losses that could be claimed following breaches of disclosure duties.

There have also been several other cases this year that have raised issues of relevance to securities litigation.

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71 [2019] EWCA Civ 40.
In the Tesco litigation, the defendants sought to strike out the claim on the basis that the claimants held their shares through CREST and that this was not an ‘interest in securities’ as required by Section 90A. Tesco accepted that its interpretation of the statute would render the cause of action redundant for the majority of shareholders, given the prevalence of securities being held in computerised form. However, it argued nevertheless that this was a consequence of the drafting of the legislation failing to keep pace with developments of a dematerialised market. The court rejected the application, no doubt troubled by the consequences of Tesco’s argument, which would be to expose a fundamental hole in the FSMA regime (and the UK’s implementation of the European Transparency Directive) in promoting accurate and timely disclosure by issuers and investor protection. The court determined that it:

must proceed on the basis that the draftsman and legislature did understand the market in intermediated securities, did not intend to strip away the rights of investors who chose that mode of holding their investment, and must have been persuaded that the words they used were appropriate to preserve and enhance those rights.\(^72\)

In the context of a collateralised loan obligation, the courts have applied principles of contractual interpretation to determine that no incentive fee was payable to the collateral manager of the CLO when the equity noteholders exercised their right of early termination.\(^73\) The court emphasised the approach that English law takes to the interpretation of contracts, particularly the documentation of traded products that will likely exist for a long time and pass through many hands, which is to give ‘particular, even paramount’ importance to the words used. After considering the documentation in question, the court concluded that the parties would expect to be bound by the language used, notwithstanding the supposedly perverse incentives to exercise early redemption that the collateral manager attempted to argue that the plain meaning of the words would create.

Finally there have been two cases raising important points of principle in the context of the funding arrangements applicable to securities litigation claims, a particular feature of the development of the landscape. The first\(^74\) in the context of the Ingenious Media litigation, makes clear that security for costs orders can be made against third-party funders (at least in respect of the portion of the claimants that they ‘substantially control or at any rate benefits from’) and that the adverse costs liability of the funders in such claims is primary, rather than secondary (such that it does not require the defendants first to seek recovery from the claimants before turning to the funder). In addition, the judgment raises significant doubt about the suggestion that a security for costs application against the funder can be met completely by pointing to claimants’ After the Event (ATE) insurance cover for adverse costs. The court concluded that there was a real, and not merely fanciful, risk that the ATE policies would not respond in full given their terms (such as avoidance for fraud or deliberate non-disclosure and other termination provisions), such that defendants would not have the same level of protection that a security for costs order would provide. Accordingly, the court held that a deduction to reflect the risks of the policies not responding fully was appropriate and security was ordered to make up the difference.

73 Deutsche Trustee Company Ltd v. Duchess VI CLO B.V. & Ors [2019] EWHC 778 (Ch).
74 Mr Nigel Rowe & Ors v. Ingenious Media Holdings plc [2020] EWHC 235 (Ch).
The second, a Court of Appeal decision,75 has dismissed the suggestion (first made in a case called Arkin v. Bochard Lines Limited (Nos 2 and 3)76) that a third-party funder’s liability for adverse costs should be limited to the amount that the funder had provided to the unsuccessful claimant. The so-called Arkin cap is, therefore, not to be treated as a binding rule; the court instead retains a broad discretion to determine the extent of the funder’s liability for defendants’ costs in the event that the claims they fund are unsuccessful. This decision will have an impact, therefore, on the risk/return assessment that must be made by third-party funders when they decide which cases to fund.

ii Public

The FCA successfully brought criminal proceedings against Fabiana Abdel-Malek (a former bank compliance officer) and Walid Anis Choucair (a day trader), following a joint investigation with the National Crime Agency, on five counts of insider dealing, based on inside information the former compliance officer had received in the course of her employment. Ms Abdel-Malek and Mr Choucair were each sentenced to three years’ imprisonment on the five counts. The convictions followed a previous trial in late 2018 that resulted in the jury failing to reach a verdict. The FCA, and previously the Financial Services Authority, has now secured 36 convictions in relation to insider dealing.

The FCA continues to focus on data collection and analysis as part of its ongoing efforts to enhance market integrity. In a speech at the 19th Annual Institute on Securities Regulation in Europe on 6 February 2020, Mark Steward (Executive Director of Enforcement and Market Oversight at the FCA) referred to three sources of data that, when consolidated, enable the FCA to examine what is happening in the markets in ‘close to real time’:

a MiFID II transaction reports: in 2019 the FCA received 9.8 billion MiFID II transaction reports, a 17 per cent increase on 2018;

b FTSE 300 order book: the FCA has begun ingesting and consolidating the FTSE 300 order book – which in 2019 generated around 150 million order reports per day – to aggregate orders in the same stock across different platforms; and

c Suspicious Transaction & Order Reports (STORs): 5445 were received from market actors in 2019.

This is one of the reasons why the FCA places great importance on the accuracy of transaction reports that are supplied by firms and has fined firms significant amounts when there have been errors in reporting. In March 2019 UBS AG (UBS) and Goldman Sachs International (GSI) were respectively issued Final Notices for either failing to report, making inaccurate reports or erroneously reporting transactions that had not occurred (or were not reportable) on millions of occasions between 2007 to 2017. UBS was fined £27,599,400 and GSI was fined £34,344,700. Both Final Notices referred to the failings in reporting having the potential to hinder the FCA’s market surveillance and monitoring capabilities and its ability to detect and investigate suspected incidences of market abuse, insider dealing and market manipulation.

The FCA has also taken enforcement action against the management of issuers. On 12 December 2019, the FCA fined Kevin Gorman, a former managing director at Braemar Shipping Services plc (Braemar), £45,000 for failing to notify personal trades. Mr Gorman

76 [2005] EWCA Civ 655.
carried out three trades in his capacity as a person discharging managerial responsibility (PDMR) at Braemar. Under MAR, PDMRs and those closely associated with them are required to notify the FCA and the issuer of every transaction conducted on their own account above a certain threshold within three business days. This includes transactions in the issuer’s shares, debt instruments, derivatives or other linked financial instruments. Mr Gorman was found to have sold shares worth a total of £71,235.28 on three occasions between 24 August 2016 and 18 January 2017 without informing the FCA or Braemar within the required three business days.

VI OUTLOOK AND CONCLUSIONS

The outlook for private securities actions will continue to be shaped and developed by the progress in the cases referred to in Section V, as well as new claims that emerge, and practitioners will be keenly observing any significant developments in those cases, particularly in relation to the untested points described in Section II. Moreover, the volatility in markets as a result of covid-19 may give rise to further claims in the securities litigation space as claimants explore the adequacy and timeliness of disclosures made prior to, and during, the crisis.

Subject to the impact of covid-19, with both an appeal on the meaning of ‘securities’ under Section 90A and the trial in the Tesco case due to take place this year, we may get some further clarity on the scope of Section 90A and some of the issues described above. In addition, there are a number of claimant firms that have widely advertised that they are seeking to bring proceedings in relation to Quindell (Watchstone), BT, Patisserie Valerie and Petrofac for widely reported issues. One can see the influence of third-party litigation funders, such as Therium, IMF Bentham and Innsworth, and the claimant bar working together to seek potential claimants.

We expect to continue seeing growth in the activities of boutique claimant firms in seeking out potential claimants to build groups when issuers make corrections to previous announcements, or in other instances of large-scale corporate failings. The use of additional technology and experience from other jurisdictions, including through the involvement of litigation funders and whether any attempt is made to meet the reliance requirement using a ‘fraud on the market’ or indirect/market-based causation theory, will be carefully monitored by all those involved in issuer-based liability claims. The outcome of all of these cases (to the extent they are not settled) will largely determine whether we see a wave of substantial standalone securities claims in that area.

The FCA remains committed to strong enforcement action and the pursuit of criminal prosecutions in market abuse cases; Mr Steward recently referred to the FCA’s continuing investment in tackling market abuse and successful prosecutions as reasons why, on certain metrics, the levels of abnormal price movements or volumes traded have fallen in recent years.77 However, the volume of new investigations and potentially some resourcing challenges may mean that cases remain longer in the regulatory pipeline in the shorter term.

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77 The FCA’s annual market cleanliness metric (the MC metric) is based on the percentage of abnormal movements in price in the two days preceding a takeover announcement. The MC metric was first published in 2008 and it found that approximately 30 per cent of takeovers showed abnormal price movements in the two days prior to their announcement. In 2019, the figure was 10 per cent.
In addition, the extension of the FCA’s new individual accountability regime, the Senior Managers Certification Regime, to all regulated firms in December 2019 may result in more enforcement investigations against senior managers of firms.

Both the FCA and the PRA have expressed concern about the potential for wider and systemic risks arising from poor use of trading algorithms and are focused on the need for firms to have robust governance, risk management and compliance standards and have issued guidance. We expect the FCA and PRA to take a similar stance to the governance and management of the use of machine learning in trading.78

The FCA is also focusing more attention on taking enforcement action in relation to market manipulation, which Mr Steward has described as ‘equally corrosive of market integrity’ as insider dealing. The inclusion of the FTSE 300 order book as a data source in its market surveillance has enhanced its ability to identify potentially manipulative trading. Its investigation work is now split 60:40 between insider dealing and manipulation, which marks a significant shift from when the FCA’s wholesale investigation caseload was almost exclusively focused on insider dealing.79

Finally, greater uncertainty regarding all aspects of securities law governed by EU legislation has, of course, been created by the UK’s exit from the EU. While the terms of the MAR EU Exit Regulations make clear that the intention is not to alter the policy approach of the current market abuse regime, a lot will ultimately depend on how the negotiations between the UK and the EU on their future relationship develop.

78 The Bank of England’s ‘Machine learning in UK financial services’ paper, dated October 2019 noted that around 25 per cent of respondent banking firms had a small-scale deployment of machine learning in sales and trading, with around 5 per cent of firms citing MiFID II/MAR as a barrier to deploying machine learning. For the time being, it appears that the detection of market abuse and other financial crime is the primary use of machine learning at banks.

79 Mark Steward speech at the 19th Annual Institute on Securities Regulation in Europe on 6 February 2020.
Chapter 8

FRANCE

Bertrand Cardi and Nicolas Mennesson

I OVERVIEW

i Sources of law

For decades, French securities laws have been passed pursuant to, or modified in accordance with, European directives or regulations. EU Member States have been required since 1989 to prohibit insider trading and empower an administrative authority to enforce such prohibition, to which the Market Abuse Directive (MAD) added 'market manipulation' in 2003. The MAD was replaced in 2016 by the Market Abuse Regulation (MAR), which extended its scope to non-regulated markets and imposed minimum levels of applicable fines. In addition, pursuant to a new Market Abuse Directive (MAD II), EU Member States had to make market abuse a criminal offence.

Pursuant to the MAR, any person qualifies as an insider as soon as they possess 'inside information', namely information relating to one or more issuers or to one or more financial instruments that is precise, non-public and likely to have a significant effect on the price.
of those financial instruments or related derivatives. Insiders are prohibited from using\(^9\) that information by acquiring or disposing of the relevant securities or related derivatives, on their own account or on behalf of a third party, either directly or indirectly. They are also prohibited from disclosing the information to any person (except for legitimate professional purposes) as well as from recommending or inducing any person to trade on the relevant securities.\(^10\)

The prohibition of ‘market manipulation’ is twofold. It includes share price manipulation, namely transactions or orders to trade that give false or misleading signals as to the supply of, demand for or price of listed securities, or that secure their price at an abnormal or artificial level, as well as transactions or orders to trade that employ fictitious devices or any other form of deception or contrivance. It also includes the dissemination of false or misleading information with respect to listed securities by any person who knew (or should have known) that the information was false.\(^11\)

The EU also adopted a number of other directives that are relevant to securities litigation, notably the Transparency Directive,\(^12\) the Takeover Directive,\(^13\) the Markets in Financial Instruments Directive and Regulation (MiFID II\(^14\) and MiFIR),\(^15\) which were adopted for the purpose of strengthening financial markets’ efficiency, resilience and transparency by regulating more types of securities and areas of broker conduct, and recently the Prospectus Regulation,\(^16\) which was adopted to ease information requirements for small and medium-sized enterprises and frequent issuers of securities.

Extensive disclosure obligations are imposed on issuers and their representatives, be they upon the issuance of securities or afterwards. In addition to periodic financial disclosure requirements, the issuers must immediately disclose to the market any inside information (as

\(v.\) AMF). Pursuant to the MAR, in the case of a protracted process intended to bring about a particular circumstance, not only may that future circumstance or future event be regarded as precise information, but also the intermediate steps of that process (MAR, Article 7.2).

\(^9\) The ECJ ruled that trading by an insider in the relevant securities ‘implies that that person has ‘used that information’ within the meaning of that provision, but without prejudice to the rights of the defence and, in particular, to the right to be able to rebut that presumption’ (ECJ C-45/08, 23 December 2009, Spector Photo Group \(v.\) CBFA). In accordance with this ruling, the AMF now considers that no infringement is committed by insiders who did not unduly utilise the advantage that the information conferred to them (AMF Enforcement Committee, 11 February 2015, société IC Télécom et autres).

\(^10\) Article 14 of the MAR.

\(^11\) Article 12 et seq. of the MAR.


\(^16\) Regulation 2017/1129 of 14 June 2017 implemented in July 2019.
defined above) relating to their own securities; they may, however, delay disclosure to avoid prejudicing their legitimate interests if the delay is not likely to mislead the public and the issuer is able to ensure the confidentiality of the corresponding information.  

The European Court of Justice (ECJ) has jurisdiction to interpret EU rules by issuing preliminary rulings, if requested by national courts. Another major protagonist is the European Securities and Markets Authority (ESMA), which is empowered to implement technical standards (after conducting, in some cases, market consultations) or take specific measures if authorised by a directive or regulation. The ESMA also provides soft law guidance that addresses practical complexities related to the European directives and regulations and is granted the power to prosecute and fine rating agencies for matters of internal governance, internal control and record-keeping failings.

Although EU law forms much of the relevant French law and regulation, French law continues to have its particularities. Provisions of the EU directives have been implemented under French law, including in the General Regulation of the French stock markets regulator, the Financial Markets Authority (AMF). In addition, the AMF provides soft law guidance and the decisions of its Enforcement Committee as well as court precedents are a significant source of law. Finally, legal doctrine tends to play a more significant role than in other jurisdictions.

For instance, French law complements EU rules by requiring any person preparing a financial transaction relating to an issuer to immediately inform the market, unless the confidentiality of the information can be ensured, and by imposing enhanced transparency requirements during public tender offers. It also requires disclosure of certain shareholders’

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17 In accordance with the MAR, the same definition of ‘inside information’ is used for the purpose of determining if the person in possession of such information is prohibited from trading and if the issuer has a duty to disclose it to the market. Pursuant to the Transparency Directive, Member States may, however, impose more stringent obligations on their issuers.

18 Article 223-2 of the AMF General Regulation.

19 For instance, the ESMA recently conducted a consultation on the MAR regulation as requested by the European Commission (ESMA consults on MAR review, ESMA press release of 3 October 2019).

20 For instance, the ESMA announced and has renewed three-month-long measures prohibiting binary options’ marketing, distribution or sale and restricting contracts for differences’ marketing, distribution or sale to retail investors in the EU (ESMA agrees to prohibit binary options and restrict CFDs to protect retail investors, ESMA Press Release of 27 March 2018 and ESMA renews binary options prohibition for a further three months from 2 April 2019, ESMA Press Release of 18 February 2019).

21 See specifically Questions and Answers on the Market Abuse Regulation (MAR), ESMA.

22 Decision of the Board of Supervisors to adopt a supervisory measure and to impose a fine, ESMA/2015/1048, 24 June 2015.

23 AMF General Regulation, Article 223-6. In two instances, the AMF imposed fines based on this provision, even though the transaction had remained confidential (AMF Enforcement Committee, 13 December 2010 and 25 June 2013).

24 Articles 231-4 et seq. of the AMF General Regulation.
agreements and provides for a series of sanctions in the event of failure to disclose the crossing by security holders of certain ownership thresholds. Also, AMF guidelines have further specified EU rules on immediate disclosure of inside information.

ii Regulatory authorities

The AMF has been empowered by French statute to investigate market abuse and other infringements to its General Regulation, and impose financial penalties. It was created in 2003 as an independent administrative organisation run by a Board of 16 members, a majority of whom are appointed based on their financial and legal expertise. The Board will initiate both the investigation and prosecution (and may offer a settlement procedure; see Section III.iii, infra), while the financial penalties are imposed by the independent Enforcement Committee of 12 distinct members (four judges, six people appointed for their financial and legal expertise and two representatives of employees of the financial industry).

Insider trading and market manipulation are also criminal offences under French law. The Public Prosecutor for Financial Matters and the Paris Criminal Court have exclusive jurisdiction for such offences. The Prosecutor may initiate an investigation either spontaneously, on the basis of any complaint lodged by anyone, or following the transmission by the AMF of its investigation report. The matter may then be referred to the Criminal Court for trial, which will be held before three judges and without a jury. Victims of the offence may participate in the trial and seek to be awarded damages.

For years, the French Constitutional Court has ruled that one could be both fined by the AMF Enforcement Committee and convicted for the same facts by the Paris Criminal Court. However, under the influence of the European Court of Human Rights, in March 2015, the French Constitutional Court overruled its earlier decision in this respect (see Section III.i, infra).

iii Common securities claims

Pursuant to French law, any third party who suffered a loss as a result of a market abuse or any other breach of applicable laws (even if the infringement has not been investigated or fined by the AMF) has a right to be compensated by the person who committed the abuse. If a contract exists between them, the victim's rights to indemnification will be governed by the contract unless the injury results in the contract (or its provisions regarding liability) being held null and void by a competent court.

26 The infringer will be automatically sanctioned by the loss of the voting rights attached to the non-disclosed publicly traded securities for two years; this sanction may be increased to five years by court order upon request of the company, any shareholder or the AMF. Additionally, non-disclosure constitutes both a criminal offence punished by a fine and an infringement of the AMF General Regulation.
27 Article 17 of the MAR; AMF, Guidelines on the permanent disclosure requirement and the management of inside information, October 2016.
29 Article 705-1 of the Criminal Procedure Code.
30 In particular ECHR, 4 March 2014, Grande Stevens and Others v. Italy, 18640/10, 18647/10, 18663/10, 18668/10 and 18698/10, confirmed recently by ECHR, 6 June 2019, C. c/ France, 47342/14.
31 French Constitutional Court, 18 March 2015, 2014-453/454 QPC and 2015-462 QPC.
32 Colmar Court of Appeal, 14 October 2003, 01/03432.
33 Article 1240 of the Civil Code.
Victims cannot be awarded damages by the AMF. They may either intervene in the criminal proceeding and seek damages in the trial (if any) or sue the infringing party before civil courts. This second option, however, is facilitated by the infringement having been investigated by the AMF because the French procedural system does not allow for discovery procedure and therefore makes it difficult for plaintiffs to prove their case in a civil court.

In the absence of any market abuse or other breach of applicable laws, investors that have suffered a loss in relation to securities may also seek to be indemnified by their financial intermediary for breach of their duty to warn them about the risks associated with the security. This duty is highly dependent on the sophistication of the client and the damage incurred would, in any case, be considered on the basis of lost opportunity. For that kind of claim, a class action is available to the clients of the financial intermediary, since 2014.

Finally, attorneys’ fee awards have, for a long time, been de minimis in France. Some courts have recently started awarding higher amounts, but they remain very variable from one case to another and are unrelated to the actual fees.

II PRIVATE ENFORCEMENT

i Forms of action

As a preliminary remark, even if French courts have admitted that all forms of market abuse (including insider trading) may result in damages for investors, all case law relating to the indemnification of investors until now has related to the dissemination of false or misleading information. Consequently, we focus on that particular infringement in this section.

Victims of market abuse have two main procedural routes to prove their case and seek indemnification. They may participate in the criminal proceeding and seek indemnification. They may participate in the criminal proceeding and the Paris Criminal Court can rule on both the criminal conviction and the damages to be awarded to any person having incurred a loss directly resulting from the offence (see Section III, infra). Victims can also initiate civil action to recover damages, especially from the persons that were held responsible for an infringement by the AMF.

It is too early to tell whether or not civil market abuse claims will be facilitated by the recent statutory provision allowing the AMF to transmit upon request its investigation report to a civil court before which an indemnification claim is pending. The AMF’s investigation report may indeed allow investors to be indemnified by executives or third parties (or even the issuer itself) that were investigated but not fined by the AMF. They could allege, for example, that the standard applicable to a breach of duty in a civil lawsuit is less stringent (mere negligence would suffice) than in a market abuse case (which requires violation, be it intentional or not, of applicable laws and regulations).

Even without access to its investigation file, the consequences of the AMF’s decisions can go beyond the persons fined for market abuse. For instance, a civil court ordered an issuer to indemnify investors because it resulted from a decision of the stock markets regulator that the issuer was in possession of (positive) material non-public information when making the
(pessimistic) press release that had led the investors to sell their shares. In another case, plaintiffs have successfully claimed damages against several directors of the issuer even though only the CEO had been fined by the AMF.

If the infringement is attributable to the issuer, investors may initiate action against the issuer or its officers or directors, who can be held responsible for the infringement. The issuer itself may also seek to receive damages from its (former) management, either for its own direct loss (such as a reputational loss) or from the damages paid by the issuer to plaintiffs (recourse action); such an action may be initiated either by the issuer’s (new) officers, or by its shareholders exercising a derivative action on behalf of the issuer.

The dissemination of false or misleading information may also be attributable to persons other than the issuer or its officers, either because those persons were involved in, and have contributed to, the dissemination of false or misleading information by an issuer (such as auditors) or because they acted independently (analysts, journalists, bloggers or any other person). Investors in the affected securities and the issuer may seek to be indemnified by those persons.

There is still no class action available with respect to market abuse cases despite longstanding lobbying to this effect, including by the AMF itself. A projected European directive enabling investors to initiate a class action in financial matters is currently being discussed but, at this stage, it only covers specific financial European regulations (such as the Prospectus Regulation), not market abuse infringements, which legal scholars have criticized. Therefore, shareholders must act individually, either alone or along with other investors. However, the Financial and Monetary Code allows certain associations to claim damages for a market abuse infringement on behalf of the investors by whom they have been appointed for that purpose. These associations may not advertise, in any manner, their action

38 Paris Court of Appeal, 26 September 2003, 2001/21885.
39 Commercial Chamber of the Supreme Court, 9 March 2010, 08-21547. In that case, however, the issuer had been declared bankrupt after an audit had revealed that its accounts were grossly inaccurate.
40 Actions brought against the issuer’s officers, either by the issuer or its shareholders, are subject to a specific statute of limitation of three years (indemnification claims are otherwise subject to a five-year statute of limitation). However, it has recently been ruled that in the event that the issuer exercises a recourse action against its officers or directors, the three-year period starts when the main indemnification claim is filed against the issuer (Commercial Chamber of the Supreme Court, 6 May 2014, 13-17632).
41 Class actions were only admitted under French law in 2014 and are available only to consumers against a professional having sold goods or provided services in breach of their legal duties, or violated antitrust laws.
45 Article L452-2 et seq. of the Financial and Monetary Code.
and solicit additional mandates, unless authorised to do so by a judicial order.46 In addition, when several shareholders of a corporation act against its officers or directors, they are entitled to appoint one of them to act on their behalf.47

ii Procedure
The court will vary in nature and location; commercial or civil courts may have jurisdiction. In addition, the plaintiff may file its claim either before the courts situated where the defendant is domiciled (or has its headquarters), where the infringement took place or where the loss was incurred.

In French civil proceedings, each party must prove its case based on the documents available to it, with limited access to documents in the other parties’ possession. Even though the judge is theoretically entitled to order that the parties produce any document relevant to the case,48 in practice, he or she will rarely do so. The most efficient way to obtain documents in the possession of the other party is to initiate a specific proceeding for the sole purpose of collecting evidence in view of a future claim.49 The proceeding must take place before filing the indemnification claim and, if successful, will typically lead to the appointment of a bailiff entitled to access the defendant’s premises and collect relevant documents.

French civil proceedings rarely rely on witnesses’ written statements or oral testimonies. Therefore, the procedure will essentially allow the parties to exchange written pleadings and pieces of evidence, and, in the end, present their argument orally before the court. A standard first instance proceeding lasts for 18–24 months. An appeal would last approximately the same, with the court of appeal reviewing the whole case, from both a factual and a legal point of view. In the event of a second appeal, the Supreme Court would rule on the legal aspects of the case only, within approximately 18–24 months.

iii Settlements
Even though the court may suggest that the parties attempt to find an amicable solution, and even organise (with the parties’ agreement) mediation or conciliation, the settlement of a civil claim does not require any judicial involvement or review. The only specific requirement for a valid settlement under French law is that it provides for mutual concessions.

iv Damages and remedies
Although case law was initially unclear regarding this issue, it now considers that the only consequence of a dissemination of false or misleading information is a loss of opportunity for the investors to make a better investment.50 As a result, the indemnity awarded to the investors will only represent a portion of their damage, interfering with the legal principle

46 Outside this legal framework, the solicitation of mandates by investors to initiate action on their behalf allows the court to consider the writ of summons null and void and therefore dismiss the claim, as it did in the proceeding initiated against Natixis by approximately 1,000 investors (Bobigny Commercial Court, 22 November 2011, RG 2010F01401).
48 Article 138 et seq. of the Civil Procedure Code.
49 Article 145 of the Civil Procedure Code.
50 Commercial Chamber of the Supreme Court, 9 March 2010, 08-21547 and 6 May 2014, 13-17632.
of full indemnification of the loss. In addition, instead of assessing the loss of opportunity on a case-by-case basis, French courts tend to award the same indemnity per share to all claimants\(^{51}\) or to broad categories of claimants.\(^{52}\)

This approach has been widely criticised, essentially because dissemination of false information only results in a loss of opportunity in specific circumstances (e.g., when the investor actually made an investment choice taking the false information into account). The same commentators further argue that investors having invested in the securities between the dissemination of false positive information and the corrective statement (or having divested in the same period in the case of false negative information) incurred a certain and direct loss, which should be entirely indemnified. According to those commentators, that loss is equal to the effect that the information had on the share price, which can be precisely quantified through an event study.\(^{53}\)

### III PUBLIC ENFORCEMENT

#### i Forms of action

The AMF has broad powers to supervise the stock markets and to investigate any related suspicious activities. Based on its findings, it may enjoin the relevant person from violating applicable laws and regulations.\(^{54}\) In the context of market abuse, however, the most common form of action is for the AMF to intervene after the fact by initiating a sanction procedure, as further described below.

For years, the same persons could be fined by the stock market regulator (currently the AMF) and also be convicted for the same facts by the Paris Criminal Court. However, under the influence of previous decisions of the European Court of Human Rights (ECHR) of 10 February 2009 and 4 March 2014,\(^{55}\) the French Constitutional Court ruled on 18 March 2015\(^{56}\) that double public enforcement of insider-trading laws against the same person for the same facts was unconstitutional.

After several consultations on this topic, the French Parliament thus amended the law in 2016 so as to avoid double public enforcement of market abuse laws against the same person for the same facts.\(^{57}\) Since then, the AMF is entitled to pursue a market abuse case only if the Public Prosecutor for Financial Matters does not, and vice versa.\(^{58}\) In the event of disagreement between them, the Public Prosecutor of the Paris Court of Appeal has full discretion to attribute the case to either one or the other.

Even though this is a clear improvement, the mechanism raises some questions regarding its application. The law sets no criteria as to which cases should be attributed to

\(^{51}\) Paris Court of Appeal, 17 October 2008, 06/09036.

\(^{52}\) Paris Court of Appeal, 17 February 2015, 10/04697.


\(^{54}\) Article L621-14 of the Financial and Monetary Code.

\(^{55}\) ECHR, 10 February 2009, Zolotoukhine v. Russia, 14939/03, and ECHR, 4 March 2017, Grande Stevens and Others v. Italy, 18640/10, 18647/10, 18663/10, 18668/10 and 18698/10.

\(^{56}\) French Constitutional Court, 18 March 2015, 2014-453/454 QPC and 2015-462 QPC.

\(^{57}\) Law No. 2016-819 reforming the market abuse enforcement system, 21 June 2016.

\(^{58}\) Article L465-3-6 of the Financial and Monetary Code.
the AMF or the Public Prosecutor for Financial Matters. This process does not involve the defendant and does not allow for any appeal or challenge, which is a questionable oversight according to several scholars.\(^5^9\)

The choice between administrative enforcement and criminal prosecution can have significant consequences for the defendant, who faces up to five years of imprisonment only before the Paris Criminal Court. Therefore, this mechanism has been criticised and may in the future be challenged on the basis of constitutional or international law arguments. It could be argued, for example, that it does not comply with the requirement of equal treatment or the principle of legality of criminal offences and penalties (which imposes the predictability of the law). Indeed, the ECHR states that when the criteria are not objective and defined there is an infringement of these principles.\(^6^0\)

ii Procedure

Investigations of any matter within the AMF’s jurisdiction are initiated by the AMF’s secretary general. The appointed investigators have extensive powers: they can request the communication of any relevant document, including phone usage data\(^6^1\), convene all relevant persons for interview, access professional premises and conduct interviews on site. If authorised by a judiciary order, they may access non-professional premises on which they can conduct interviews and they can seize relevant documents on any premises. At the end of its investigation, the AMF sends a draft report and a draft statement of objections, on which the investigated parties then have one month to provide comments. Based on these comments and the final investigation report, the AMF Board decides whether to initiate a sanction procedure.

If a sanction procedure is initiated, the AMF Board sends to respondents a statement of objections, on which they have two months to comment. The AMF Board also transfers the file to the AMF Enforcement Committee, which appoints one of its members as rapporteur. The rapporteur will review the case, conduct further investigation, if needed, and opine on the merits of the objections in a report, on which respondents have 15 days to comment. After a hearing during which the rapporteur, a representative of the AMF Board and the respondents will present their oral arguments, the AMF Enforcement Committee will rule on the case.

Its decision may be appealed before the Paris Court of Appeal or the French Administrative Supreme Court, depending on whether or not the respondents are professionals of the finance industry working under the AMF’s supervision. The ruling of the Paris Court of Appeal may be appealed before the Supreme Court. The whole proceeding before the AMF (including the investigation phase) lasts for between two and four years. Each appeal takes 18–24 months. The Public Prosecutor for Financial Matters has full discretion to initiate a preliminary investigation and to transmit the file to an investigating magistrate.\(^6^2\) Both the Prosecutor and


\(^{60}\) ECHR, 22 November 1995, S.W. v. the United Kingdom, 20166/92.

\(^{61}\) The legal framework for the AMF’s collection and use of phone usage data has been amended in 2018, at the request of the French Constitutional Court, so that an independent supervisor ensures that the defendants’ rights are safeguarded.

\(^{62}\) The investigating magistrate is a judge in charge of reviewing all aspects of the case, theoretically both in favour of and against the prosecuted persons. The Prosecutor may also refer the matter directly to the
the investigating magistrate have the same powers as in any criminal case, including access to premises, seizure of documents and conduct of interviews. If the investigating magistrate considers that there is enough evidence, he or she will refer the prosecuted parties for trial before the Paris Criminal Court. At the hearing, the Court will conduct a full review of the case, possibly involving experts and fact witnesses.

The three-year statute of limitations for infringements investigated by the AMF was recently harmonised with the six-year statute of limitations applicable in criminal matters. As opposed to the AMF sanction procedure, the criminal prosecution allows victims of the offence to take part in the process. They have access to the file as soon as an investigating judge is appointed with a right to require additional investigation and to challenge the investigating magistrate’s decisions. In the event of trial, the victims will participate in the trial and be entitled to submit written as well as oral pleadings.

iii Settlements

Initially, only disciplinary proceedings (i.e., involving financial industry professionals) could be settled with the AMF. Law No. 2016-819 of 21 June 2016 has extended the scope of the AMF settlement procedure to all infringements falling within the AMF’s jurisdiction, such as the breach by issuers or shareholders of transparency requirements and market abuse (see Section V, below).

The first settlements in market abuses cases took place in 2017 and such procedure appears to have proven effective, with a similar number of market abuse settlements in 2018 and 2019. The settlement has a major edge over the sanctions proceedings before the AMF: it saves significant time and does not require any admission of guilt or a public hearing. According to the AMF, before the settlement was extended to market abuse, almost all defendants accepted settlement when offered. Nevertheless, the French Administrative Supreme Court has recently decided that the AMF Enforcement Committee may refuse to ratify a settlement when the case raises a new and difficult question that the Committee considers that it should be ruled on in accordance with ordinary procedure. The AMF Board acknowledged this decision, which, in its view, may ‘jeopardize the use of the settlement procedure, either from the point of view of the AMF Board or from the point of view of the defendant’.

Even if settlement of criminal cases is theoretically possible under French law, it remains exceptional in practice. A settlement with the victims of the offence is always

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63 Composed of three judges but no jury.
64 ‘Loi relative à la croissance et la transformation des entreprises’ of 23 May 2019.
65 Overall, three AMF Settlements related to market abuse were concluded in 2019, four in 2018 and five in 2017.
67 French Administrative Supreme Court, 20 March 2020, 422274.
68 See ‘The AMF acknowledges the decision of the Administrative Supreme Court regarding settlement procedure’, AMF press release, 20 March 2020.
69 Articles 41-2 and 495-7 of the Criminal Procedure Code; article L465-3-6, X, of the Financial and Monetary Code.
possible; however, it will only deal with civil damages and avoid any further involvement of the victims. Such a settlement will not prevent the prosecution from being continued, and the trial from being held, if the Public Prosecutor or the investigating judge deems it appropriate.

iv  **Sentencing and liability**

The AMF is entitled to impose financial penalties of up to the higher of: (1) €100 million, (2) 10 times the profit resulting from the infringement, or (3) 15 per cent of the defendant’s consolidated turnover (if applicable). It may also impose other types of sanctions (such as a warning or a prohibition on conducting certain businesses) on the professionals of the financial industry acting under its supervision. The amount of the fine is based on (inter alia) the seriousness of the infringement and the advantages obtained or profits gained by the infringing party. The decision is made public, unless its publication may significantly disturb the financial markets or harm the infringing parties in which case it may be anonymised.

The Paris Criminal Court can impose fines of at least the amount of the profit resulting from the offence (if any) and up to the higher of: (1) €100 million, (2) 10 times the profit resulting from the infringement, or (3) 15 per cent of the defendant’s consolidated turnover (if applicable), and imprisonment for up to five years. This applies to insider trading as well as market manipulation.

**IV  CROSS-BORDER ISSUES**

In relation to securities admitted to trading on a French multilateral trading facility (or other securities not admitted to trading on such markets, but the value of which depends on those securities), the AMF has jurisdiction for all market abuse infringements, even if entirely committed outside France. In relation to securities admitted to trading on a regulated market in an EU/EEA Member State (other than France), the AMF has jurisdiction for all market abuse infringements committed in France.

As for criminal proceedings, the Paris Criminal Court has jurisdiction and French criminal law applies as long as the offence was entirely or partially committed in France, even in relation to securities of a foreign issuer that is not listed in France. The same would be true for an offence entirely committed outside France if the victim was a French national at the time.

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70 Article L621-15 of the Financial and Monetary Code.
71 As a result, it remains intricate to prevent the decision of the AMF Enforcement Committee to be published; however, parties may request that it be anonymised.
72 The fine amounts mentioned in this paragraph are the maximum fines that may be imposed on natural persons. For legal entities, the maximum fine referred to under (1) is €500 million.
73 Unconditional imprisonment of persons convicted for market abuse is rare in France. Indeed, to our knowledge, it has happened in only two cases.
74 Article L465-1 et seq. of the Financial and Monetary Code.
75 Article L621-15 of the Financial and Monetary Code and Article 611-1 of the AMF General Regulation.
76 Article 113-2 of the Criminal Code. This was confirmed in an insider-trading case relating to a US corporation (the shares of which were only listed in the United States) where the order to purchase shares had been made in France (Criminal Chamber of the Supreme Court, 3 November 1992, 92-847/45).
77 Article 113-7 of the Criminal Code.
In international civil cases, the court having jurisdiction and the applicable law will depend on the applicable international conventions. In a case involving several EU Member States, EU Regulation 1215/2012 will allow plaintiffs, if they are able to demonstrate that the infringement took place in France, to file a complaint before French courts. Against a defendant outside the EU, in the absence of any convention to the contrary, plaintiffs will be entitled to seek indemnification (on a non-contractual basis) before a French court if the infringement or the resulting loss took place in France. In both cases, EU Regulation 864/2007 will trigger the application of French law if the loss was incurred in France.

V YEAR IN REVIEW

In 2019, the AMF Enforcement Committee again rendered numerous significant decisions. A news agency was fined for having released reports on an issuer that turned out to be false and likely to set the company's stock price at an abnormal or artificial level. After reaffirming its previous ruling that provisions specifically applicable to the press only apply to journalists acting within the scope of their professional duties, the AMF Enforcement Committee added that the right for journalists to communicate information to the public is protected as long as they act in good faith, based on accurate facts, and provide specific and reliable information in compliance with their deontology, which primarily includes the duty to verify that the information is authentic.

Another recent decision of the AMF Enforcement Committee is worth noting. After the AMF had declared a proposed public tender offer in kind non-compliant with applicable laws, the bidder acquired a significant amount of the target's share capital through contribution agreements with shareholders. The AMF Board charged the bidder for wrongfully pursuing the non-compliant exchange offer. The AMF Enforcement Committee ruled that the bidder had neither initiated the non-compliant public exchange offer, nor initiated a substitute public exchange offer, and therefore had not breached the rules governing public tender offers.

The AMF Enforcement Committee also imposed a €20 million penalty on a bank for having manipulated derivatives on French treasury bonds. It also fined two Elliott entities that had acquired derivatives relating to the securities of a French issuer targeted by a public tender offer to block the squeeze-out of minority shareholders. A total fine of €20 million was imposed on the two entities for having failed to properly disclose the derivatives in question and to reveal in timely manner that they intended not to tender the underlying securities.

In a more typical decision, the AMF Enforcement Committee ruled that the disclosure requirement relating to the default on a payment due date in the context of a restructuring plan of an issuer in financial difficulty cannot be delayed, as it constitutes an event that could jeopardise the issuer's perspective and, if not disclosed, could be misleading to the public.

78 Article 46 of the Civil Procedure Code.
81 AMF Enforcement Committee, 31 December 2019, SAN-2020-01.
82 AMF Enforcement Committee, 4 December 2019, SAN-2019-16.
83 AMF Enforcement Committee, 17 April 2020, SAN-2020-04.
84 AMF Enforcement Committee, 17 April 2019, SAN-2019-04.
As regards procedural aspects, the AMF Enforcement Committee increasingly uses its ability to fine defendants for having obstructed an AMF investigation by refusing to provide documents or information, to comply with a subpoena or to grant access to professional premises. For the first time, the AMF Enforcement Committee sanctioned entities for obstruction even though they were not the infringing parties themselves but affiliates, while pointing out that business secrecy cannot be asserted as a defence in the context of an AMF investigation. More recently, a defendant was fined for having provided the information requested by the AMF investigators only partially and after almost two years.

The Paris Court of Appeal also clarified the conditions for the admissibility of (1) appeals lodged against AMF decisions, (2) the arguments raised to support such appeals and (3) the observations of the AMF. In another case, the Paris Court of Appeal pointed out to the AMF Enforcement Committee that the decision regarding the amount of a sanction for market abuse must be as justified as the characterisation of the market abuse itself. The Court nevertheless upheld the sanction decided by the AMF Enforcement Committee and merely provided the missing justification regarding its amount on the basis of (1) the gravity of the market abuse committed by a seasoned investor, on repeated occasions and using an elaborate operating procedure, and (2) the defendant’s earnings and assets.

VI OUTLOOK AND CONCLUSIONS

One of the potential major topics ahead is shareholder activism. According to legal scholars, shareholder activism will lead to market abuses infringements in the future. For example, the hypothesis of an activist disseminating false or deceptive information to artificially distort the stock price of an issuer and then take advantage of it through a previously constituted investment position would result in several market abuse infringements with regard to the MAR Regulation.

Several reports on activism have been published in the past six months, calling for further legislation in order to impose a level playing field between issuers and activists. The AMF has taken part in this public debate by proposing, among others, to lower the first ownership threshold that must be disclosed by security holders to 3 per cent (from 5 per cent) of the issuers’ share capital or voting rights and to be granted the power to issue injunctions regarding investors (and not only to issuers) and to impose a penalty if its injunctions are not complied with.

In such a context, consideration should also be given to the implementation of a new French regulation dedicated to proxy advisers. Such entities must now disclose to the public their code of conduct and information regarding the preparation of their research, advice and

85 Article L621-15, II, f, of the Financial and Monetary Code.
87 AMF Enforcement Committee, 17 April 2020, SAN-2020-04.
88 Paris Court of Appeal, 23 May 2019, 18-18638.
89 Paris Court of Appeal, 19 December 2019, 19/00495.
91 AMF communication on shareholder activism, 28 April 2020.
voting recommendations. Moreover, proxy advisers are now required to prevent, manage and inform their clients of any conflict of interest and business relationship that may influence their research, advice or voting recommendations.92

Finally, the AMF Enforcement Committee’s chairman publicly emphasised recently that insider information still predominate in the area of financial transparency.93 Given the ongoing situation resulting from the covid-19 health crisis, the AMF recently reminded issuers that they are required to disclose as soon as possible an assessment of this specific and unforeseen risk on the conduct of their activities and those of their customers.94

92 ‘Loi relative à la croissance et la transformation des entreprises’ of 23 May 2019 and see Didier Fornoni, ‘Coup de projecteur sur les proxy advisors, leur rôle, leur influence et les moyens de la contrôler’, Bulletin Joly Bourse (July 2019), p. 27 et seq.
93 12th symposium of the AMF Enforcement Committee - Address by Marie-Hélène Tric, Chairman of the AMF Enforcement Committee, 4 October 2019.
I  OVERVIEW

i  Sources of law

Civil law

Securities constitute a private law contract between the issuer and the security holder. German securities are, therefore, primarily governed by civil law, namely, the law of obligations (codified in the German Civil Code) and – as far as equity securities are concerned – by corporate law.

Individual types of securities or specific features of their legal status can be subject to specific civil law legislation, sometimes with public law elements. For example:

- **a** bonds and the rights of bondholders are dealt with in the Bonds Act (SchVG);
- **b** the safekeeping of securities is governed by the Safe Custody Act (DepotG); and
- **c** the Stock Corporation Act includes numerous provisions that apply specifically to public stock corporations (i.e., stock corporations listed on a regulated market). According to modern academic interpretation they form – together with relevant capital markets supervisory law (see Section I.ii) – what is called the ‘law of public stock companies’.²

Supervisory law

Publicly offered or traded securities as well as issuers and intermediaries are subject to a comprehensive set of regulations, which are supervised and enforced by the German Federal Financial Supervisory Authority (BaFin). Security-related supervisory law in Germany is deeply rooted in harmonised European legislation, which aims to create an integrated European financial market. The most prominent example is the revised Markets in Financial Instruments Directive (MiFID II),³ which was implemented into German national law with effect from 3 January 2018, becoming effective together with the Markets in Financial Instruments Regulation (MiFIR). The MiFID II/MiFIR rules contain provisions on investor protection, in particular on safeguarding of clients’ assets, product governance and monetary and non-monetary inducements, as well as a comprehensive regulation of market infrastructure (trading venues and systematic internalisers).

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1 Lars Röh and Tobias de Raet are partners at lindenpartners Partnerschaft von Rechtsanwälten mbB.
3 Directive 2014/65/EU.
In addition, the updated Market Abuse Directive (MAD II) and a new Market Abuse Regulation (MAR) became effective as of July 2016. MAR has replaced a large amount of national law and establishes a single rule book on market integrity. The new framework applies equally to traditional trading platforms, multilateral trading facilities (MTF) and organised trading facilities (OTF). MAR regulates, among other things, insider trading, market manipulation, ad hoc disclosure of inside information, over-the-counter trading and high-frequency trading. The implementation of MAD II has provided for a massive upgrade of administrative sanctions in case of deliberate or negligent offences against MAR rules.

Furthermore, the UCITS-Directive and the AIFMD harmonise the supervisory requirements for open-end and closed-end funds, the Prospectus Regulation provides for rules on the drawing up and approvals of prospectuses to be published when securities are offered to the public or admitted to trading on a regulated market, and the Take Over Directive provides for a European framework for public mandatory and takeover bids.

Meanwhile the European Securities and Markets Authority (ESMA) covered (nearly) all areas of MiFID II, MiFIR, MAR and UCITS-Directive/AIFMD with a comprehensive set of guidelines and Q&As. While being formally addressed to the national competent authorities, such ‘soft law’ is regarded as de facto binding by market participants in the course of their day-to-day operations. In addition, BaFin issued separate FAQs on MAR and revised further parts of the Issuer’s Guide. Module C – ‘Regulations under the Market Abuse Regulation (MAR)’ of the 5th edition of the Issuer’s Guide was published on 22 April 2020 and replaces Chapters III to VII of the 4th edition of the Issuer’s Guide. The revised and updated version takes into account in particular the changes that have been brought about by the MAR and other new regulatory laws in the EU and Germany. In addition, further examples from practical work have been included and explanations (e.g., relating to intermediate steps) have been made more precise reflecting recent case law.

Against this background, the following (most relevant) pieces of supervisory law relating to securities in Germany are to be construed in the light of their respective European framework legislation:

- the Securities Trading Act (WpHG), which includes provisions on investment services and ancillary investment services of banks, the disclosure of major shareholdings in public companies and the publication of financial reports by public companies;
- the Capital Investment Code (KAGB), which regulates the issuance and marketing of collective investment funds, covering both undertakings for collective investment in transferable securities (UCITS) and non-UCITS (also known as alternative investment funds);
- the Securities Acquisition and Takeover Act (WpÜG) regulating the takeover and mandatory bids for the acquisition of shares in public companies. In spite of its economic importance, the takeover of private companies has not been regulated specifically until now.

4 Directive 2014/57/EU.
6 Directive 2014/91/EU.
7 Directive 2011/61/EU.
9 Directive 2004/25/EU.
11 In spite of its economic importance, the takeover of private companies has not been regulated specifically until now.
the Securities Prospectus Act (WpPG), which applies to the drawing up, approval and publication of prospectuses for securities to be offered to the public or admitted to trading on a regulated market.

ii Common securities claims

Apart from claims pursuing the mere fulfilment of contractual duties, such as a claim for due payment according to the final terms of a bond, most securities claims are based on wrongful capital markets disclosure or other abusive behaviour that results in securities holders suffering a loss. Except for the liability of credit rating agencies under the Credit Rating Agency Regulation (CRAR)12 (see ‘Wrongful ratings’, below), there is no specific written law that regulates securities claims. Accordingly, a significant amount of case law has evolved.

The following claims are the most common ones:

Incorrect or omitted publication of inside information

Overview

The issuers of financial instruments shall inform the public as soon as possible of inside information that directly concerns them (Article 17(1) MAR). The rule addresses issuers of all kind of financial instruments that are traded on a regulated market, as well as on MTFs and OTFs. Article 7(2) and (3) MAR clarify that in the case of a protected process (such as the early resignation of a member of the board of directors, or a transaction) the intermediate steps as well as the final event may be deemed to be inside information and trigger the obligation to publish this information. This provision implements the reasoning of the European Court of Justice in the Geltl/Daimler case.13 In addition, Article 17(4) MAR refines the rules on a temporary withholding of inside information by the issuer. Module C of the 5th edition of BaFin’s Issuers’ Guide, published in April 2020, now contains detailed explanations and examples on the question of in which cases intermediate steps constitute independent inside information.

Case law

Until 2002, claims for damages were based on (general) tort law and very often failed to fulfil the statutory requirements as interpreted by the courts. The leading case on this is Infomatec, in which the Federal Court of Justice (BGH) held members of the management of Infomatec AG responsible for the wilful dissemination of false information.14 The court reasoned that such wilful action was contrary to boni mores (i.e., it was immoral) and granted damages pursuant to Section 826 BGB.15 In later decisions, the BGH refined this line of argument.

13 ECJ, judgment of 28 June 2012 (Case No. C-19/11); cf. also the corresponding ruling of the Federal Court of Justice (BGH), decision of 23 April 2013 (Case No. II ZB 7/09), NZG 2013, p. 708 et seq. (Geltl/Daimler AG).
14 Infomatec AG (a mobile telephone provider) had published an ad hoc notification stating that it had received an offer for purchase of the company’s products with a total order volume of more than 55 million deutschmarks (approximately €30 million). In fact, the binding part of the order had a volume of only 9.8 million deutschmarks. Immediately after the ad hoc notification the share price rose by 20 per cent. For a summary of the facts as well as the judgment, see Koch in European Capital Markets Law (Veil (ed.) 2013), Section 19, Paragraph 111 et seq.
15 BGH, judgment of 19 July 2004 (Case No. II ZR 218/03), BGHZ 160, p. 134 et seq.
In *EM.TV* the court clarified that an issuing company is liable for the wilful actions of its managers (Section 31 BGB). In *Comroad*, however, the BGH emphasised the prerequisite of a full proof of causation between the incorrect notification and the plaintiff’s decision to acquire or sell shares, which, in most cases, is difficult to furnish.

The special rules on liability in Sections 97 and 98 WpHG (previously, until 3 January 2018 Sections 37b and 37c) were introduced to facilitate claims for damages against an issuing company. Under Section 97 WpHG, shareholders only need to show that the company did not publish inside information without undue delay, that they acquired the shares after the information should have been published and that they still held the shares when the information came to light. The shareholder can claim the difference between the share price that was originally paid and the share price the shareholder would have paid had the information been published in time. The company is only exempt from liability if it can prove that its managers acted neither wilfully nor with gross negligence. The BGH, however, denied a similar reversal of the burden of proof if the claimant aims to retrieve the full share price that was initially paid (while concurrently offering to transfer the shares to the company); in this case the shareholder will need to prove that he or she would not have bought the shares had the disclosure obligation not been breached.

From an investor’s point of view, one of the disadvantages of Sections 97 and 98 WpHG is their scope of application, which is limited to the issuing company. In a number of cases issuers have become insolvent when threatened with a large number of claims for damages. This is one of the reasons why investors continue to seek damages against the members of an issuer’s management under the general tort law provision of Section 826 BGB.

**Shareholders v. Volkswagen AG and Porsche Automobil Holding SE**

The case against Volkswagen AG (VW) is well known around the world. VW admitted to having used a ‘defeat device’ in approximately 11 million diesel cars, which helps to reduce emissions of nitrogen oxide and carbon dioxide when the cars are in testing mode.

On 22 September 2015, VW published an ad hoc notification admitting the use of a defeat device and announcing that it will set up accruals of about €6.5 billion. Within days of the information breaking, the price of preferred shares in VW’s dropped by 40 per cent. The statements from the US Environmental Protection Agency (EPA) and VW suggest that for several years VW may have deceived authorities, investors and customers as to the actual level of pollutant emissions of some of VW’s most promising car models. Apart from multiple lawsuits in the United States and elsewhere, a significant number of which have been settled by VW, the company is confronted in German courts with claims by investors under the former Section 37b WpHG (since 3 January 2018, Section 97 WpHG) and Section 826 BGB, with the volume of claims filed at the Regional Court of Brunswick by more than

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17 BGH, guidance order of 28 November 2005 (Case No. II ZR 80/04), NZG 2007, p. 345; see Koch (footnote 8), Section 19, Paragraph 114.
18 For a discussion on possible alleviations of the proof of causation, see ibid., Section 19, Paragraph 115.
19 See Zimmer and Grotheer in Kapitalmarktrechts – Kommentar (Schwark/Zimmer (ed.) 2010), Section 37b WpHG, Paragraph 2 et seq.
20 As Koch (footnote 8) points out, none of the other EU Member States, with the exception of the United Kingdom, provide a special legal framework for the breach of the obligation to disclose inside information.
21 BGH, judgment of 13 December 2011, NJW 2012, p. 1,800; Koch (footnote 8), Section 19, Paragraph 120.
1,500 shareholders being around €9 billion in aggregate. In addition, Porsche Automobil Holding SE (Porsche), the majority shareholder of VW, is facing claims made by its own shareholders for reasons similar to those affecting VW. However, this, combined with the fact that there had been personnel integration between VW and Porsche at management level, has triggered 'model proceedings' (see Section II.i): the Regional Court of Brunswick accepted several 'establishment objectives' applied for by plaintiffs and VW, and submitted these to the Higher Regional Court of Brunswick. The latter appointed a model plaintiff; following further submissions by the parties a series of oral hearings has been taking place since 10 September 2018. Similarly model proceedings have been initiated in the cases of shareholders against Porsche, with the District Court of Stuttgart delivering an order with detailed reasoning regarding why it accepted certain establishment objectives while rejecting others. The Higher Regional Court of Stuttgart, however, overturned the decision of the district in March 2019 and held that the lawsuits brought forward against Porsche were ultimately based on the same facts as those against Volkswagen itself. They were thus to be assigned to the model proceedings at the Higher Regional Court of Brunswick. Only when these proceedings have been concluded with final and binding effect will it be possible to clarify further questions relating specifically to Porsche in separate proceedings. The decision can still be appealed before the BGH.

Shareholders v. Hypo Real Estate Holding

The downfall of Hypo Real Estate Holding AG (HRE) is an outstanding example of the impact of the 2008 global financial crisis in Germany. HRE was a commercial property lender and financing company, the shares of which were admitted to trading at the Frankfurt Stock Exchange. It ended up in a complete bail-out acquisition by the German government.

In mid-January 2008, HRE announced by way of an ad hoc notification a considerable depreciation of its portfolio of collateralised debt obligations in the amount of €390 million. Within one day, the price of HRE shares dropped by 35 per cent. A diverse group of investors (including retail investors, but also large investment funds) claimed damages against the company totalling about €1 billion, arguing that the write-offs should have been disclosed as early as autumn 2007. In December 2014, the Higher Regional Court of Munich ruled in favour of the plaintiffs in a model proceeding. The BGH has not yet rendered its judgment on the appeal on points of law.

22 Regional Court of Brunswick, decision of 5 August 2016 (Case No. 5 OH 62/16).
23 Higher Regional Court of Brunswick, Case No. 3 Kap 1/16.
24 Regional Court of Stuttgart, decision of 28 February 2017 (Case No. 22 AR 1/17 Kap). In a further decision of 6 December 2017, the court initiated separate model proceedings regarding issues of local jurisdiction (Case No. 22 AR 2/17 Kap).
25 Higher Regional Court of Stuttgart, Case No. 20 Kap 2 – 4/17.
27 Ibid.
Market manipulation

Overview

Article 12 MAR sets out detailed rules on market manipulation, provided that the manipulative action may influence the market price of financial instruments. The rules apply to all kinds of markets, including OTF and MTF. They extend to manipulative high-frequency trading and to the abuse of benchmarks. Article 15 MAR prohibits market manipulation, as well as attempts to engage in market manipulation.

In contrast to the treatment of deceptive ad hoc disclosure, German law does not provide for civil sanctions in cases of market manipulation. This might change with the MAR, which strongly emphasises investor protection.²⁹

Under German tort law, the general provision to claim damages is Section 823(2) BGB, which requires the breach of a ‘protective provision’ by the injuring party. In consequence, courts have had to deal with the question of whether the former Section 20a WpHG, which was repealed with the introduction of Article 12 MAR, constitutes a protective provision. The BGH rejected this assertion in the IKB case, holding that the national rules primarily aim at ensuring the functioning of the markets on a macro level.³⁰

As a result, former Section 20a WpHG only provided for supervisory actions and penal sanctions. Therefore, as was the case with incorrect disclosures of inside information until 2002, investors were restricted to claim damages against the issuer and its managers on the grounds of wilful causation of damage contra bonos mores (Sections 826, 31 BGB). Again, investors faced great difficulty in proving that these requirements were met.

Hedge funds v. Porsche (re Volkswagen)

The takeover battle between Porsche AG (subsequently Porsche SE) and Volkswagen AG was one of the most thrilling events in recent German economic history. In summary, in March 2008 Porsche announced its intent to acquire 50 per cent of the shares in Volkswagen following a continuous stake-building by Porsche since 2005. Shortly thereafter, Porsche declared that it would not acquire a stake of 75 per cent or more in Volkswagen. This announcement resulted in heavy short sales by market participants. During the following months, Porsche continued to buy shares and cash-settled equity swaps for shares in Volkswagen up to a total of 74.1 per cent. In October 2008, Porsche announced its intention to raise its holdings up to 75 per cent, which led to a sharp rise in the market price of Volkswagen shares.³¹ Hence – having bet on falling prices – short sellers suffered severe losses amounting to approximately €10 billion to €15 billion.³²

In August 2014, the Higher Regional Court of Stuttgart admitted a criminal trial against former members of the Porsche management on the grounds of market abuse. The indictment alleged that certain managers intentionally disguised their intention to acquire

³⁰ BGH, judgment of 13 December 2011 (Case No. XI ZR 51/10), NJW 2012, p. 1800. On the facts and ruling of the case, see Mock (footnote 23), Section 20a WpHG, Paragraph 475; BGH, decision of 15 November 2016 (Case No. KZR 73/15), BeckRS 2016, 21465.
³¹ For a brief time on 28 October 2008, Volkswagen was the world’s most valuable company.
³² On the facts see Möllers, NZG 2014, pp. 361 and 362.
a stake of at least 75 per cent in Volkswagen in a series of press communications between March and October 2008.\textsuperscript{33} However, the Regional Court of Stuttgart rendered a non-guilty verdict in March 2016.\textsuperscript{34}

Under civil law, investors have filed claims for damages against both Porsche and Volkswagen on the grounds of information-based market manipulation and incorrect publication of inside information. Most claims have been dismissed. The Higher Regional Court of Stuttgart decided that the incorrect press releases of Porsche did not qualify as a wilful causation of damage in a particularly reproachable manner, thus rejecting claims on the grounds of Sections 826 and 31 BGB.\textsuperscript{35} The Court further held that Section 20a WpHG would not provide for monetary compensation of investors. The BGH upheld this decision.\textsuperscript{36} Similarly, the Higher Regional Court of Brunswick reasoned that Sections 37b and 37c WpHG (now Sections 97 and 98 WpHG) would not apply to press releases, arguing that they do not reach the ‘quality’ of ad hoc notifications, and it dismissed the claims filed against Porsche.\textsuperscript{37}

On the other hand, the Higher Regional Court of Celle proceeds with a model proceeding filed by aggrieved investors against Porsche and Volkswagen.\textsuperscript{38} While this proceeding has recently been delayed due to several (and ultimately successful) challenges of bias by the plaintiffs directed at the presiding judge and the outcome of this proceeding is still open, the decisions illustrate that rulings may differ between the Higher Regional Courts.

**Takeover law-related claims**

**Overview**

Pursuant to Section 10(1) WpÜG, a bidder must publish without undue delay its voluntary decision to submit an offer to the shareholders of the target company. Section 35(1) WpÜG provides that the same applies if a bidder obtains direct or indirect control over the target company. The law irrefutably presumes a controlling position of the bidder if it holds 30 per cent of the voting rights of the target company.\textsuperscript{39} In this case, a mandatory offer must be published.

Under Section 12 WpÜG, the shareholders of the target company are entitled to damages if they have tendered their shares on the grounds of an incorrect or incomplete offer document. In legal practice, however, case law rather deals with the timeliness of an offer since the time of an offer sets the amount of the consideration.\textsuperscript{40} In this respect, debates focus on the question of how to determine whether and when a person has acquired direct or indirect control over a target company. Voting shares of third parties may be attributed to the bidder (Section 30 WpÜG), but usually the facts are not as clear as voting rights held by a subsidiary

\textsuperscript{33} Decision of 18 August 2014 (Case No. 1 Ws 68/14), ZIP 2014, p. 1829.
\textsuperscript{34} Regional Court of Stuttgart, decision of 18 March 2016 (Case No. 13 KLs 159 Js 69207/09); the judgment is final.
\textsuperscript{35} Judgment of 26 March 2015 (Case No. 2 U 102/14), BeckRS 2015, 05690; in this case hedge funds claimed damages in the amount of €1.76 billion for losses suffered as a result of short selling in 2008.
\textsuperscript{36} Decision of 15 November 2016 (Case No. KZR 73/15), BeckRS 2016, 21465.
\textsuperscript{37} Judgment of 12 January 2016 (Case No. 7 U 59/14), NJW-RR 2016, 624.
\textsuperscript{38} Decision of 5 December 2016 (Case No. 13 Kap 1/16), BeckRS 2016, 115907; becklink 2005201; cf. also Weber, NJW 2017, p. 991, 993 f.
\textsuperscript{39} See Section 29(2) WpÜG.
\textsuperscript{40} Pursuant to Section 31(1) WpÜG in conjunction with Sections 4 and 5 WpÜG-AngebotsVO (WpÜG Offer Ordinance) the consideration must be ‘reasonable’.  

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of the bidder. In the case of Schaeffler/Continental, BaFin had to deal with the difficult question of whether cash-settled equity swaps held by a minority stakeholder (Schaeffler Group) could convey direct or indirect control over the target company (Continental AG). The prevailing view is that they do not. In addition, the rules on acting in concert appear even more controversial and relevant in practice.

Minority shareholder v. Deutsche Bank (re Postbank)

In September 2008 Deutsche Bank AG and Deutsche Post AG, the holding company of Postbank AG, signed an agreement that granted Deutsche Bank the right to acquire 29.75 per cent of the shares in Postbank plus the right to acquire a further 18 per cent within 12 and 36 months after the acquisition of the first stake. In January 2009 Deutsche Bank and Deutsche Post amended their agreement and redefined their cooperation. Thereafter, Deutsche Bank purchased 22.9 per cent of Postbank shares and in October 2010 submitted a voluntary takeover bid to the free-float shareholders of Postbank.

Since the offered purchase price was unattractive, a minority shareholder sued Deutsche Bank for a higher consideration on the assumption that Deutsche Bank should have made a takeover bid as early as October 2008 or January 2009. At both times the market price of Postbank shares was considerably higher. The plaintiff alleged that Deutsche Bank had passed the threshold of 30 per cent by acquiring the right to purchase additional shares from Deutsche Post in September 2008 or at least because of the attribution of the voting rights held by Deutsche Post, with the attribution resulting from the cooperation agreement between the two companies. In July 2014 the BGH expressed sympathy for the latter assumption.

In addition, the BGH decided on a number of controversial legal issues. First, it granted shareholders of the target company who had tendered their shares to the bidder a right against the bidder to demand an adjustment of the offered purchase price if the latter was found to be unreasonable. Some commentators had argued that shareholders faced with an unreasonable offer were merely entitled to damages for an incorrect or incomplete offer document pursuant to Section 12(1) WpÜG. By acknowledging the shareholders’ right to demand an adjustment of the purchase price, the BGH rejected this view. The court further distinguished this breach of obligation by the bidder from a situation in which the bidder omits to publish a mandatory offer altogether. In this situation shareholders are not entitled to damages. Finally, the BGH affirmed the view that the attribution of voting rights held

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41 On the facts, see Habersack, AG 2008, p. 817 et seq.; and Schanz, DB 2008, p. 1899 et seq.
43 See von Bülow (footnote 36), Section 30 WpÜG, Paragraph 203. See also, for example, regarding the WMF case, Veil in European Capital Markets Law (Veil (ed.) 2013), Section 24, Paragraph 53 et seq.
44 See also BGH, judgment of 29 July 2014 (Case No. II ZR 353/12), NZG 2014, p. 985, Paragraph 56 et seq.; the court remanded the case to the Higher Regional Court of Cologne for further investigation of the cooperation agreement and final judgment.
45 BGH, judgment of 29 July 2014 (Case No. II ZR 353/12), NZG 2014, p. 985, Paragraph 19 et seq.
by a third party requires that the bidder disposes of an unconditional right to acquire these shares and that the (simple) contractual right against a third party to demand the transfer of the shares does not suffice.48

The ruling of the BGH strengthens the rights of shareholders and at the same time provides clarity for investors and bidders. Somewhat ironically, Deutsche Bank later announced the divestment of Postbank as part of its consolidation strategy.49

While the case that the BGH remanded to the Higher Regional Court of Cologne is still pending (with an oral hearing having taken place at the end of March 2019 and witness hearings in November 2019), in the meantime the District Court of Cologne has ruled in favour of other plaintiffs in parallel cases.50

Prospectus liability

Overview

Section 21 et seq. WpPG provides a cause of action for an investor who acquires securities that are admitted to trading on a regulated market where the underlying prospectus contains incorrect or incomplete information.51 The list of persons who can be held liable for the losses that the investor has incurred is fairly broad and encompasses the issuer, persons who have assumed liability for the prospectus (e.g., the guarantor) and other persons who initiated the publication of the prospectus.52 If securities of an issuer domiciled outside Germany are also admitted to trading on a foreign regulated market the investor may only establish a claim under German law if the securities were purchased on the basis of a transaction concluded in Germany or an investment service fully or partially rendered in Germany (Section 21 WpPG, Paragraph 3).

The investor is entitled to rescind the purchase contract and render the securities against reimbursement of the purchase price provided that the purchase was concluded after publication of the prospectus and within six months of the first listing of the securities. If the investor is no longer the owner of the securities, he or she may claim the payment of the difference between the purchase price and the selling price of the securities.

A defendant cannot be held liable if it can prove that it was not aware of the incorrectness or incompleteness of the prospectus and that this ignorance was not because of gross negligence. In practice, however, it is very difficult for a defendant to provide such exonerating proof.53

Section 23 WpPG provides for further exclusions of the defendant’s liability. For example, the investor will fail with its claim if the defendant can show that the investor knew that the statement in question was inaccurate or incomplete (Section 23 WpPG, Paragraph 2).

Section 306 KAGB provides for similar rules in respect of units or shares in investment funds, where the defendant is either the management company or any other person who has

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49 See de la Motte and Maisch, ‘Und ab die Postbank’, Handelsblatt, 27 April 2015.
50 District Court of Cologne, decision of 20 October 2017 (Case No. 82 O 11/15).
52 See further ‘Secondary liability’.
53 See Groß, Kapitalmarktrecht (Sixth Edition, 2016), Section 23 WpPG, Paragraph 77 ‘probatio diabolica’.
taken responsibility for the accuracy of the prospectus. Section 165 KAGB lists in detail the necessary content of such prospectuses (in the specifically important case of closed-end funds in conjunction with Section 269 KAGB).

Until July 2005, no disclosure requirements existed with regard to certain non-securitised investments, such as closed-end funds, which were most often structured as a GmbH & Co KG.\(^{54}\) Mainly for tax reasons, these investments were particularly popular among retail investors. As a result, it is not surprising that a lot of case law on prospectus liability involves the liability for these ‘grey market’ investments. In this regard, courts have distinguished between the prospectus liability in a restrictive sense and in a broader sense. While the former deals with the general liability of certain persons for an incorrect prospectus because of their interest in the issuance, the latter deals with the liability of persons who provided confidence in the investment.\(^{55}\)

In general, courts tend to issue investor-friendly rulings. This has increasingly been the case, with persons held responsible for the issuance of securities or financial instruments as well as alleviations of the burden of proof of causation and damages.\(^{56}\) The case law also supports the interpretation of the complex prospectus liability rules set out in Section 306 KAGB.\(^{57}\)

**Shareholders v. Deutsche Telekom AG**

A well-known case on prospectus liability relates to the third initial public offering (IPO) of Deutsche Telekom AG shares in the year 2000. The company was formed in 1996 when the formerly state-owned monopoly Deutsche Bundespost was privatised. In December 2014, the BGH held that the prospectus published by Deutsche Telekom AG for its third IPO contained misleading statements on the valuation of the company’s real estate assets and on certain shares held by a subsidiary.\(^{58}\)

**Wrongful ratings**

**Overview**

In recent years, investors have commenced lawsuits against credit rating agencies based on the ground that claimants allegedly relied on the accuracy of the rating when making their investment decision and the rating later turned out to be inaccurate. Such legal action has been fostered by a reform of the CRAR.\(^{59}\) Pursuant to Article 35a CRAR,\(^{60}\) investors have a claim for damages against a credit rating agency if the latter has intentionally or grossly negligently committed one of the infringements listed in Annex III of the CRAR and this

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\(^{54}\) This is a general partnership, with the general partner being a limited liability company. See also Zoller, *Die Haftung bei Kapitalanlagen* (Second Edition, 2014), Section 5, Paragraph 4 et seq.

\(^{55}\) While in both cases the basis for a claim is in contract law (Sections 280(1) and 311(2)(3) BGB), the two forms of liability differ with regard to the persons held responsible and the limitation of actions. On the distinction, see Emmerich in *Münchner Kommentar zum BGB* (Säcker, Rixecker and Oetker eds., Sixth Edition, 2012), Section 311, Paragraph 147 et seq.

\(^{56}\) See also Zoller (footnote 48), Section 5, Paragraph 20 et seq. and Section 6.

\(^{57}\) Likewise, see ibid., Section 6, Paragraph 9.

\(^{58}\) BGH, judgment of 21 October 2014 (Case No. XI ZB 12/12), NJW 2015, p. 236; Higher Regional Court of Frankfurt am Main, decision of 30 November 2016 (Case No. 23 Kap 1/06).


\(^{60}\) Article 35a being inserted by the 2nd Reform Regulation to the CRAR (Regulation (EU) No. 462/2013).
has affected a credit rating. Until Article 35a came into force, claims for damages had to be asserted exclusively under national civil law. Since the legal framework in Germany did not provide for specific liability rules for wrongful ratings, investors had to draw their claims on general civil law liability or compensation rules.

**Investor v. rating agency**

In 2018, the Higher Regional Court of Düsseldorf dealt with both the scope of Article 35a CRAR and the applicability of general civil law principles to false ratings. According to the Court's judgment, Article 35a CRAR does not establish any liability of a credit rating agency towards the investor if its rating relates to the issuer of the financial instrument acquired by the investor but not to the financial instrument itself.61 Further, the court held that the rating agreement concluded between the issuer and the rating agency in the case of a issuer rating does not establish any protective obligations towards investors who acquire a financial instrument of the rated issuer.

**Wrongful investment advice**

**Overview**

Claims based on wrongful investment advice are usually filed against the advising bank or individual advisers. Disclosure obligations of the advising banks vary on a case-by-case basis. In 1993, the BGH ruled in a principle-establishing judgment that any given advice must be investor-specific, which requires that a recommended product shall match with the risk tolerance of the customer, and investment-specific, meaning that the adviser must inform the client about all material aspects of the product.62 Courts tend to render investor-friendly judgments and to hold advisers responsible for even minor disclosure infringements.

**Retail investors v. investment banks (re Lehman Brothers)**

For several years, case law had involved, in particular, holders of Lehman Brothers securities who had filed claims against their investment banks for wrongful investment advice. The BGH has dismissed most of these claims.63 In November 2014, however, the court found in favour of the plaintiffs that the bank's advice lacked information on an exceptional right of termination of the Dutch issuing company (Lehman Brothers Treasury Co BV) and granted damages to the plaintiffs.64

**Secondary liability**

The liability of third persons (i.e., neither the issuer nor its managers or directors) plays a minor role in German securities litigation. In theory, advisers of an issuer, such as attorneys, lawyers and investment banks, may be held liable if they intentionally cause damage that

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61 Higher Regional Court of Düsseldorf, judgment of 8 February 2018 (Case No. I-6 U 50/17).
63 E.g., BGH, judgment of 27 September 2011 (Case No. XI ZR 182/10), NJW 2012, p. 66. See also BGH, judgment of 15 October 2013 (Case No. XI ZR 51/11). Regarding the latter, see Zoller (footnote 48), Section 2, Paragraph 113 et seq.
64 BGH, judgment of 25 November 2014 (Case No. XI ZR 169/13), NJW 2015, p. 398.
is contrary to public policy (Section 826 BGB). With regard to the liability for incorrect or omitted publication of inside information as well as for market manipulation, these requirements are difficult to prove (see Section I.ii, ‘Market manipulation’).

In legal practice, secondary liability is confined to the field of prospectus liability, without substantial differences between prospectuses published for securities admitted to trading on a regulated market (Section 21 WpPG) and those published for investment funds (Section 306 KAGB). An action for damages can be brought against the banks issuing the securities, against accounting firms that audited the incorrect prospectus and whose final report is included in the prospectus and against any other person upon whose initiative the publication is based or who assumes responsibility for it. German legal literature does not, however, assume liability of advisers who drew parts of the prospectus or advised on its content (such as attorneys, tax lawyers or experts) unless they have a particular economic interest in the issuance of the securities.

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### II PRIVATE ENFORCEMENT

#### i Forms of action

Currently, there are no types of action in Germany comparable to class actions as they are known in the United States. Nonetheless, in 2005, the German legislator introduced the Capital Markets Model Case Act (KapMuG), which provides for a very specific form of class action (model cases) for capital markets litigation. The Act allows for a concentration of legal or factual issues concerning a great number of pending or future proceedings in one court.
to reduce the caseload caused by mass litigation and to prevent contradictory decisions on similar issues. The scope of the KapMuG is, however, very limited; only claims for damages or for contractual performance can be pursued in these ‘model proceedings’ – and only if the claim can be based on wrongful capital markets information (damages) or can rely on offers according to WpÜG (performance claims). Also, these model proceedings do not abandon the rule that any injured party must litigate its own case and prove its own damages. Rather, the KapMuG allows for parties who actively choose to participate in the model proceedings to receive a preliminary ruling on legal or factual questions that are of significance beyond their individual cases. Also, the German capital markets model proceedings require every potentially injured party to actively opt in to the proceedings. Only those parties who have actively chosen to participate in the model proceedings will be legally bound by the rulings and, in particular, only those parties can make use of the preliminary ruling when proceeding with their individual cases.

Whether investors make use of the model proceedings under the KapMuG or not, as the law currently stands they will always have to initiate an individual claim against an issuer before the competent regional court. The regular rules of procedure apply as provided for in the German Code of Civil Procedure (ZPO).

Further, on 1 November 2018, the so-called Model Declaratory Action Act (MuFKG) entered into force in Germany. The model declaratory action is intended to facilitate collective redress for consumers in cases of mass damages caused by large companies.

The model declaratory action was introduced in the wake of the diesel scandal involving Volkswagen and other car manufacturers. In the view of the German legislator, a large number of diesel car owners hold claims against the relevant car manufacturers due to the diesel scandal. The German legislator takes the position that so far there have not been effective procedural means for diesel car owners to successfully assert and enforce their claims in court against the diesel car manufacturers. The model declaratory action is intended to change this. Broadly speaking, the concept of the MuFKG is to entitle consumer protection associations and other ‘qualified entities’ to sue enterprises, seeking a model declaratory judgment on legal or factual issues relevant for a multitude of similar cases on which, if successful, individual consumers may subsequently base their individual claims against the enterprise. What is interesting with a view to securities litigation, is the fact that the new Act does not expressly exclude capital-market-related claims from its scope so courts will have to determine whether the KapMuG and MuFKG exclude or partly overlap each other. The prevailing opinion in German legal publications is that the scope of application of the model declaratory action also encompasses capital-market-related claims. Therefore, it is possible that investors (provided they qualify as consumers as required under the MuFKG) may base potential claims on both the KapMuG and the MuFKG – which might lead to ‘competing’ law court judgments on an identical issuer.

ii Procedure

Since securities constitute private law contracts between the parties, the ordinary civil courts of justice are competent to decide disputes between the parties. The procedural rules are laid down in the ZPO.

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71 Lutz in ZPO (BeckOK), Section 606 ZPO, Paragraph 8.1; Rathmann, in ZPO (Saenger (ed.), Section 606 Paragraph 4; Vollkommer, in ZPO (Zöller (ed.), 32nd Edition, 2018), Section 606 Paragraph 2.
The two single most obvious differences between the ZPO and common law rules of civil procedure are the outstanding significance of written pleadings in German civil courts and the absence of discovery proceedings.

Written pleadings

The original principle of German civil procedure, according to which the essential parts of a lawsuit should be conducted orally, has been reversed over the past 100 years into proceedings that are based almost entirely on written pleadings.

With the effective service of the statement of claim on the defendant, the action is pending. The statement of claim must comprehensively present all the relevant factual allegations on which the claim is based. Upon receipt of the statement of claim the defendant is required to file its defence, normally within a period of three to five weeks, to which the plaintiff may reply. There is no limit to the number of briefs that each side may subsequently submit to the court before the first hearing. Before the hearing takes place, all relevant legal and factual aspects of the case shall have been presented to the court in writing and very strict rules apply restricting any delayed presentation of facts. The hearing is preceded by settlement negotiations conducted by the court. If the court does not succeed in settling the case amicably, the settlement negotiations are immediately and automatically followed by the (main) hearing, which is generally a fairly short event in which the court orally presents the facts of the case and each party has an opportunity to comment on them.

The main hearing will either be followed by a judgment, which terminates the first instance, or the court might schedule an additional hearing for taking evidence, such as hearing witnesses or experts testimony before rendering its judgment. Judgments of first instance become final and binding unless they are appealed against within one month of being rendered.

No discovery proceedings

It is a basic principle of German civil procedure that the parties enjoy a wide discretion in deciding which issues and which factual allegations they choose to present to the court. It is in their discretion to determine their allegations and counter-allegations as well as the factual claims that they intend to prove by evidence and the type of evidence they would like to present.

The parties are obliged to tell the truth. Judges are under a general duty to clarify the facts and allegations and to this end may obtain information from public sources and may order the presentation of documents if they have been referred to by, and are in the possession of, a party to the dispute. However, there is nothing in German civil procedure

72 Greger in ZPO (Zöller (ed.), 32nd Edition, 2018), Section 128 ZPO, Paragraph 1 et seq. and Section 129 ZPO, Paragraph 1 et seq.
73 Section 253 ZPO.
74 Sections 296 et seq. ZPO.
75 Section 278(2) ZPO.
76 Section 279 ZPO.
77 Greger (footnote 62), Section 128 ZPO, Paragraph 10.
78 Section 138(1) ZPO.
79 Section 358a No. 2 ZPO.
80 Section 142 ZPO.
even remotely resembling subpoena proceedings or disclosure proceedings as they are known in the US legal system. There simply exists no general duty on one party to produce all relevant material in its possession.

Consequently, as there is no obligation to disclose all the facts of a case to the court, there are (with very minor exceptions) no pretrial discovery proceedings in German law of civil procedure. Therefore, the parties depend on other sources of information, which may involve requests under the German Freedom of Information Act or requests to access records of criminal investigations if the case is being investigated by public authorities. Administrative courts, however, have strengthened the right and obligation of BaFin to withhold information that concerns third-party rights.

The most significant consequence of the parties’ wide discretion to determine the factual allegations and evidence to be submitted to the court is that any factual allegations that remain uncontested by the other party are deemed to constitute a true fact on which a judgment can be based without any further proof.

Settlements

It is a key principle in German civil proceedings that the court shall facilitate an amicable solution of the legal dispute (Section 278 ZPO). A dispute litigated in court may be settled at any time within or outside the proceedings. A settlement may, in particular, be reached by submitting a proposed settlement to the court. The court will not review the proposed settlement for adequacy or fairness of the terms. However, the court may refuse to issue an order establishing that a settlement has been reached if the settlement violates mandatory statutory law or public policy.

Special rules apply in proceedings under the KapMuG. The model plaintiff and the model defendant may conclude a settlement before the court by submitting to the court a proposed settlement of the model proceedings and of the original individual cases or by accepting a settlement proposed by the court (Section 17 KapMuG). The proposed settlement must also be submitted to any intervening party, namely, plaintiffs under parallel proceedings who have not been chosen as the model plaintiff. Intervening parties may comment on the settlement and may reject their participation (opt out) within one month of receipt (Section 19 KapMuG). Unlike in standard civil proceedings, the proposed settlement also requires approval by the court including on the adequacy of the settlement, taking into account the status of the model proceedings and the result of consultation with intervening parties (Section 18 KapMuG). The settlement will become valid and binding upon approval by the court, provided that less than 30 per cent of the intervening parties opt out of the settlement.

Attorneys’ fees are governed by professional rules stipulated by the Lawyers’ Remuneration Act (RVG). Attorneys are under an obligation to charge at least the fees stipulated by this act for representation in court cases. These fees depend on the value of the dispute. An attorney who contributes to finding a settlement that ends the dispute is entitled to an additional statutory fee.

81 See also Higher Regional Court of Frankfurt am Main, decision of 16 May 2013 (Case No. 20 VA 4/13), BeckRS 2013, 12264.
82 VGH Kassel, judgment of 3 March 2015 (Case No. 6 A 1071/13), BeckRS 2015, 46064, relying on a decision of the ECJ dated 12 November 2014 (Case No. C-140/13); Weber, NJW 2015, p. 2307, 2308.
83 Section 138(3) ZPO.
**Damages and remedies**

Remedies for violations of securities laws, including the determination and calculation of damages, depend on the cause of action. Generally, damages for violations of securities laws shall result in a natural restitution to the extent of the negative interest. That means that the claimant is to be placed in a position that it would have been in had the relevant law not been violated. Depending on the cause of action and the current status, this may include a right of choice. For example, in the case of incorrect publication or failure to publish inside information (Sections 97 and 98 WpHG), the investor may choose either to reverse the relevant securities transaction or to claim the difference between the price actually paid and the price that would apply, if the information had been duly published.84

This principle also applies to the prospectus liability. The investor may claim either reimbursement of its expenses (particularly including the capital contribution and any premium) against return of the shares and an earned interest or for compensation of the reduced value of the shares plus interest resulting from the inaccurate or omitted information. The claim for damages includes indemnification against tax and other disadvantages resulting from the investment. In addition, the investor may claim for loss of profit from a missed opportunity of an alternative investment.

Damages comprise, and are limited to, the actual loss suffered (i.e., there are no punitive damages). As a general rule, the investor bears the burden of proof of the loss and of its causation by the violation. However, there are concepts that ease or even shift the burden of proof from the investor. Where the issue of whether or not a loss has occurred and its amount are in dispute, a German court shall rule at its discretion and based on its evaluation of all circumstances (Section 287 ZPO). The concept of prospectus liability also includes a reversal of the burden of proof regarding the causation of the acquisition of the share or interest by the inaccurate or omitted information, which means that the defendant must prove that the investor would have acquired the shares even if it had been properly informed.

**III PUBLIC ENFORCEMENT**

i **BaFin**

BaFin supervises and enforces compliance with the requirements of all security-related supervisory rules (see Section I.i) and may issue orders provided that they are appropriate and necessary. For example, pursuant to Section 6(2) WpHG, BaFin may temporarily prohibit the on-exchange trading in individual shares to the extent that this is necessary to enforce the prohibitions or requirements pursuant to the WpHG (e.g., market manipulation).

To this effect, BaFin may request anyone to provide information, present documents and surrender copies as well as summon and question persons. During usual business hours, employees of BaFin must be given access to the property and business premises.

BaFin can publish on its website decisions that it has taken against companies for not complying with the provisions of the WpHG, provided that such decisions are legally binding, the authority deems the publication suitable and necessary and it would not significantly endanger the financial markets or lead to disproportionate damage to the parties involved and the publication (Sections 123 to 126 WpHG).

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84 BGH, judgment of 13 December 2011 – Case No. XI ZR 51/10.
ii Sanctions, prosecutor and cooperation

In the event of a deliberate or grossly negligent breach of supervisory rules, German law provides for two classes of sanctions: criminal penalties for serious breaches and administrative fines for minor cases. The competent authority for the imposition of administrative fines is BaFin, while public prosecutors are responsible for the prosecution of criminal matters. Both authorities work closely together. With the implementation of MAD II and MiFID II, administrative fines have been increased substantially (as set out in Section 120 WpHG).

BaFin has to report without undue delay to the competent public prosecutor information on facts leading to the suspicion that a criminal offence may have been committed. It may transfer personal data of relevant persons who are under suspicion or who are contemplated to act as witnesses to the public prosecutors to the extent that this is necessary for purposes of criminal prosecution.

In return, the public prosecutor informs BaFin of the commencement of any investigation proceeding in respect of criminal offences. If experts are required during the investigation proceedings, employees of BaFin with the relevant knowledge can be called upon. If the public prosecutor considers discontinuing the proceedings, it is required to take the view of BaFin into consideration.

IV CROSS-BORDER ISSUES

There are no specific laws in place for cross-border securities litigation; rather the general rules for cross-border litigation apply. Generally, a non-EU foreign issuer that does not maintain a branch office in Germany can only be subjected to legal proceedings before a German court if the parties have agreed on German jurisdiction, either when entering into a contract or at any time thereafter (Section 38 ZPO). The situation is principally the same if the foreign issuer has its corporate seat in the EU (see Article 25 of Regulation (EU) No. 1215/2012). German courts will always apply German rules of civil procedure, while the applicable substantive law is determined by conflict-of-law rules, the primary source of which in this case is the Regulation (EU) No. 593/2008 (the Rome I Regulation). A choice of law made by the parties is generally recognised under these rules (Article 3 Rome I Regulation), subject to certain exceptions such as overriding mandatory provisions (Article 9 Rome I Regulation) that may become relevant in the context of securities litigation.85

The degree of complexity that can be reached in cross-border securities litigation cases even within the EU (or especially in the EU) is demonstrated by the highly controversial case of HETA Asset Resolution AG (HETA), an Austrian ‘bad bank’ with many German – mainly institutional – creditors. On 1 March 2015, the Austrian Financial Market Authority (FMA) ordered a moratorium on the payment of HETA’s unsecured obligations until 31 May 2016. The decree was based on the Austrian Federal Law on the Recapitalisation and Liquidation of Banks, which implements the European Banking Recovery and Resolution Directive 2014/49/EU (BRRD) in Austria. The HETA case is the first example of the application of a liquidation measure under the provisions of a national implementation law of the BRRD. German HETA creditors called upon the Regional Court of Frankfurt am Main. The Court indicated that it may not acknowledge the moratorium.

85 See also Martiny in Münchner Kommentar zum BGB (Säcker, Rixecker and Oetker (eds.), Volume 11, Sixth Edition, 2015) Article 9 Rom I-VO, Paragraph 74 et seq.
In June 2016 the court presented the case to the European Court of Justice to clarify a number of questions on the BRRD (preliminary ruling procedure).\textsuperscript{86} In particular, the ECJ shall decide whether the BRRD applies to an entity in resolution, which has lost the quality of a credit institution before the expiry of the implementation period.

Meanwhile a major agreement has been reached between a large number of investors that are not parties to the pending trials and the Austrian state of Kärnten, which could be liable for the outstanding debt.\textsuperscript{87}

\section*{V YEAR IN REVIEW}

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Again, Volkswagen (see Section I.ii) has been the most outstanding event in the area of securities litigation in Germany. The Higher Regional Court of Brunswick has held eight oral hearings up to the end of March 2020, but has not yet come to a decision on the various ‘establishment objectives’ brought forward by both plaintiffs and defendants so far. Given the current constraints caused by the covid-19 pandemic a decision is unlikely to be adopted before 2021.
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Multiple tax refunds known as cum-ex deals have been paid much attention by the media, market participants and German courts in 2019/2020. In the first criminal trial in Germany, on 18 March 2020, the Regional Court of Bonn considered cum-ex deals under specific circumstances a criminal offence.\textsuperscript{88} Accordingly, the court sentenced the accused stock traders to suspended sentences (probation) for aiding and abetting tax evasion in a particularly serious case.\textsuperscript{89} Previously, the Fiscal Court of Cologne had already classified the transactions as illegal under tax law. The question of whether they are also punishable under criminal law has now been affirmed in the positive by the Regional Court of Bonn.
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\section*{VI OUTLOOK AND CONCLUSIONS}

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We expect the Dieselgate complex of VW and Porsche to remain the leading case also in the coming year.
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Further, it is likely that market participants (investors, asset managers, banks and custodians) will try to seek recovery for trading losses, retrospective tax payments and penalties incurred in the context of cum-ex deals, and will sue each other before civil law courts. Depending on the contractual relationship they have with each other such claims may be based on alleged wrongful advice, breach of contractual duties or joint and several compensation.
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It is also likely, that the covid-19 pandemic, which started to disrupt the global economy in spring 2020, will lead to a significant increase in securities litigation cases after the crisis has been overcome. Investors may try to sue companies that did not (or not in timely manner) disclose the effects of the pandemic situation on their business operations in accordance with the laws (e.g., in their annual report or in ad hoc notifications).
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\textsuperscript{86} Decision of 21 June 2016 (case. No. 2-12 O 114/15), WM 2016, 1681.

\textsuperscript{87} ‘Fast alle Gläubiger akzeptieren nachgebessertes Angebot’, Handelsblatt, 10 October 2016.

\textsuperscript{88} District Court of Bonn, judgment of 18 March 2020 (Case No. 62 KLs 1/19).

\textsuperscript{89} Fiscal Court of Cologne, judgment of 19 July 2019 (Case No. 2 K 2672/17).```
In addition, BaFin will probe stock transactions made ahead or after the sharp market downturn stemming from the spread of coronavirus. Severe losses in stock prices combined with alleged insider trading or failure to comply with ad hoc disclosure requirements may give rise to claims of investors and asset managers against other market participants or issuers.
I OVERVIEW

i Sources of law

The Italian legal framework relating to securities may be basically divided into European legislation, Italian primary legislation and Italian secondary legislation.

As far as European legislation is concerned, the following main sources are:

a Directive 2014/57/EU on criminal sanctions for market abuse (market abuse directive);


d Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (Prospectus Regulation).

The most relevant domestic law provisions are set forth by the Legislative Decree 58/1998 (Consolidated Law on Finance), Legislative Decree 385/1993 (Consolidated Law on Banking). A number of articles of the Italian Civil Code, Criminal Code and the Codes of Civil and Criminal Procedure are also relevant in this context.

Finally, some principles and guidelines for the application of the legislation on securities may be drawn from European and Italian case law, which may have a significant impact on the interpretation of the applicable laws and regulation, although in the Italian system precedents are not to be considered binding strictu sensu.

ii Regulatory authorities

The most important authorities in charge of the supervision of the market are: the Companies and Exchange Commission (CONSOB), the Bank of Italy and the Ministry of Economy and Finance. The Commissione Vigilanza sui Fondi Pensione (COVIP) and the Institute for the Supervision of Insurance (IVASS) are responsible for the supervising of pension funds and insurance companies respectively.

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1 Daniele Geronzi, Stefano Parlatore and Daria Pastore are partners, and Bianca Berardicurti is a managing associate at Legance – Avvocati Associati.
CONSOB is the supervisory authority for the Italian financial products market. CONSOB’s aims are to protect investors and the efficiency, transparency and development of the market, and to ensure correctness in the conduct of business through the adoption of specific rules against intermediaries’ wrongdoings and the enforcement of penalties set forth by the law.

The Bank of Italy is the central bank of the Italian Republic. It performs activities of general interest in monetary and financial matters, including risk containment, management and financial supervision of intermediaries, banks and financial institutions. Its supervisory role not only consists of remote control activities but also entails on-site inspection and ensuring the adoption of administrative measures (e.g., authorisations or penalties).

The Bank of Italy is also designated as the Italian authority empowered to apply the resolution tools and exercise the resolution powers in accordance with Article 3 of Directive 2014/59/EU, establishing a framework for the recovery and resolution of credit institutions and investment firms.

Among many other tasks, the Ministry of Economy and Finance is also responsible for outlining the requirements of competence, integrity and independence of, inter alia, the corporate representatives of intermediaries, security brokerage firms and asset management companies.

COVIP is the authority responsible for the proper and transparent administration and management of pension funds, also controlling the financial management of those funds.

IVASS is responsible for the management of insurance and reinsurance companies, for the transparency and fairness of the companies operating in the field and for the protection of policyholders and that of the consumers.

The Bank of Italy, CONSOB, COVIP and IVASS cooperate and exchange relevant information to facilitate each other’s functions. In that respect they cannot mutually oppose professional secrecy.

Banca Italiana S.p.A. is the authority responsible for the organisation and management of the Italian stock exchange.

Finally, the pivotal role of the civil and criminal judicial authorities must be considered in supervising and regulating the securities market due to the crucial part they play in the interpretation and application of the law.

### Common securities claims

The Italian legal system provides investors with a number of claims primarily aimed at protecting them from any breaches of civil or regulatory obligations or failures to comply with criminal provisions (e.g., insider trading) on the part of market players.

The most common claims arising from securities offerings are caused by market players’ breach of the information duties set forth by the law – such as false, inaccurate or omitted information in the prospectus (see Section II.i).

In general terms, security claims may be brought before ordinary civil courts or before public authorities. The heads of liabilities and the forms in which securities actions might be brought in those cases are discussed in greater detail in Sections II.i, II.ii, III.i and III.ii).
II  PRIVATE ENFORCEMENT

i  Forms of action

Security claims may be brought before ordinary civil courts. The relevant procedural traits are outlined below in Section II.ii.

The heads of liability of most security claims are as follows.

**Liability for breaches of the rules of conduct imposed on financial intermediaries**

In the context of their activity, financial intermediaries shall abide by the general principle of good faith, which constitutes a basis of the Italian legal framework governing contracts.

In addition, intermediaries shall comply with the standards of due diligence, fairness and transparency set forth by Article 21 of the Consolidated Law on Finance, and with the ‘know your customer’ or ‘suitability’ rules – as implemented by the subsequent CONSOB regulations – to protect the investor’s best interests and to ensure that they are actually provided with adequate and correct information. As a consequence, financial intermediaries are to be held liable for damages occurring to the investor due to breaches of their obligations, either on a pre-contractual or contractual basis, depending on whether the damage arises before or following the execution of the relevant investment agreement.

**Liability for wrongdoings by credit rating agencies**

Pursuant to Article 35-a of Regulation (EC) No. 1060/2009 of the European Parliament and the Council of 16 September 2009 on credit rating agencies, as subsequently amended by Regulation (EU) No. 462/2013, rating agencies shall be held liable for the damages incurred by investors and issuers on the basis of a credit rating affected by the rating agency’s gross negligence or wilful infringement.

**Liability for the wrongdoings of directors**

Pursuant to Articles 2395 and 2396 of the Italian Civil Code, directors or general managers shall be held liable for the damages incurred to shareholders and third parties as a consequence of their wilful misconduct or negligence.

The above claim may be particularly complex in terms of burden of proof, as the plaintiff is required to give evidence that the damage suffered is not a mere reflection of the damage suffered by the company (by way of example, the damage arising from the write-off of financial investment caused by the mismanagement conducts carried out by the administrative body).

**Liability for the failure to propose mandatory takeover bid**

Pursuant to Article 106 of the Consolidated Law on Finance, anyone who, following acquisitions or increased voting rights, has a 30 per cent shareholding or more than 30 per cent of the voting rights of a company, must propose a mandatory takeover bid to buy the entirety of the securities related to the same company admitted for trading on a regulated market. As a consequence, in the event of failure to propose the mandatory takeover bid, security shareholders may seek compensation for damages that, according to recent case law, shall be considered as contractual in nature (see Supreme Court, judgment No. 20560/2015).
**Prospectus liability**

Pursuant to Article 94, Paragraph 8, of the Consolidated Law on Finance, the issuer, offeror or guarantor or any other person or entity responsible for the information contained in the prospectus, shall be held liable, within the limits of their duties, for the damages suffered by an investor who has reasonably relied on the truthfulness and completeness of the information contained therein.

In addition, pursuant to Article 94, Paragraph 9, of the Consolidated Law on Finance, liability for false information or omissions that are likely to influence the decisions of a reasonable investor may also lie with the intermediary responsible for the securities’ placement. The issue of whether prospectus liability claims are contractual, pre-contractual or tortious in nature has been a much discussed item among scholars and in case law. In this respect – although most recent decisions tend to recognise the tortious nature of prospectus liability – it is important to consider that the relevant framework provided by the Consolidated Law on Finance ultimately makes this debate less crucial, as it is expressly provided that (1) the statute of limitation is five years, which is typical of tortious claims; and (2) with regard to the burden of proof, the defendant is considered liable unless he or she proves that due diligence was adopted to ensure that the information was consistent with the real situation and did not contain omissions capable of affecting its meaning. Such shifting of the burden of proof is typically observed in contractual claims under Italian law.

**Liability for the lack of diligence of the auditing companies**

Pursuant to Article 15 of Legislative Decree No. 39/2010, auditing companies shall be held liable, jointly with the person in charge of the auditing activities, for the damages suffered by the commissioning company, their shareholders and third parties, as a consequence of their failure to observe due diligence in the execution of their duties.

**Liability for the failure to perform the duty of supervision of the supervisory authorities**

Supervisory authorities might be held responsible for the losses incurred by the investors also due to their failure to perform their duty of supervision. The authorities’ liability is by nature in tort.

Depending on the circumstances, the claim may be brought by the claimant either on an individual basis or through a class action, which was introduced in the Italian legal system nearly 10 years ago. Pursuant to Articles 139–140-bis of the Consumers Code (Legislative Decree No. 206/2005), referred to in Article 32-bis of the Consolidated Law on Finance, consumers or users may collectively advance a claim if they hold homogenous positions with respect to the same offence carried out by the same enterprise.

Owing to the scarce use of class actions by Italian consumers in recent years, the Italian legislator recently intervened with a general and overall reform of class actions. Articles 139–140-bis of the Consumer Code will then be repealed by Law No. 31/2019, starting from 19 November 2020.

Among the most relevant amendments that the repealing act is set to introduce in the class action regulation, are that (1) both physical persons and companies will be entitled to bring class actions claiming a breach of homogeneous individual rights; (2) both contractual and tort liability will be enforceable through the new class action; and (3) from a procedural
point of view, conduct of the action through the fast track summary proceedings provided under Article 702-bis of the Italian Code of Civil Procedure will be introduced. Similarly, the new regulation shapes the class action on an opt-in based model.

ii Procedure

No special features exist in the Italian legal system for proceedings regarding security claims brought before the ordinary civil courts. The procedure set out by the Italian Civil Procedural Code shall apply.

Claims are handled by local courts in the first instance and the Court of Appeal in the second instance. Proceedings before the Supreme Court may be brought only with the limited scope of claiming a failure in the correct application of law by the lower courts.

Before commencing a security claim concerning insurance, banking and financial agreements, the parties shall start the mandatory mediation procedure pursuant to Article 5 of Legislative Decree No. 28, dated 4 March 2010. Such a step is held to be a procedural requirement; as a consequence, lacking fulfilment of the mediation stage, the judge grants the parties a 15-day compliance period.

If the mediation procedure is not successful or if the claim does not fall under the list provided by Article 5 of Legislative Decree No. 28/2020, the security claims shall directly follow the ordinary path set forth by the Italian Code of Civil Procedure.

Ordinary proceedings are commenced with the plaintiff serving the initial complaint upon the respondent at least 90 days prior to the proposed date for the first hearing (this term is extended to 150 days if the defendant is located outside the Italian Republic). The above term is mandatory, it being established by the Civil Procedural Code in order to put the defendant in a position to duly present its case.

After the first hearing, the judge issues the parties with deadlines to file the three briefs pursuant to Article 183 of the Italian Code of Civil Procedure, in which the parties can provide further consideration on the merits and evidence requests and form a reply, arguing any evidence.

Once the investigation phase is completed and the judge considers the case ready to be decided, the parties are granted 60 days and 20 days for the filing of the final briefs and reply briefs respectively. The judgment is then issued within the following 60 days.

Given the above, there are some peculiarities that should be taken into account when dealing with Italian law procedure.

First, based on the general principles governing evidence under Italian law, the burden of proof depends on whether the claim in question is contractual or tortious in nature.

If the claim is contractual in nature, while the plaintiff is only required to claim that the defendant has not complied with the agreement, the defendant shall give evidence that it has duly performed its obligations; on the other hand, should the claim be tortious in nature, the plaintiff shall be requested to prove:

a. the wilful or negligent conduct of the defendant;
b. the damage suffered; and
c. the causal link between the conduct and the damage.

However, besides the general principles described above, specific burden of proof provisions might be provided by the applicable laws governing security claims. Such exceptions are based, to a large extent, on the proof–proximity principle, and tend to allocate the evidential burden to the party to whom the evidence is available or who is better situated to easily lead
it. By way of example, so far as damages deriving from the failure to propose the takeover bid are concerned, the plaintiff shall not prove the causal link referred to under point (c) above, but will only be required to prove its security-holder status at the time when the takeover bid should have been proposed and the loss of profits arising from the failure to propose the takeover bid.

Second, under Italian law the statute of limitation is 10 years for contractual liability and five years for liability in tort. However, if the breach also amounts to a crime (e.g., insider trading or market manipulation) and the applicable criminal law provides for a longer statute of limitation, then the longer criminal statute of limitation shall apply to civil actions.

The statute of limitation period cannot be extended or shortened by the parties, but in some cases set forth by the law it can be suspended or interrupted by the interested party.

Third, no disclosure phase is provided for by the Italian procedural system. Parties are generally free to choose which documents they need to file within the proceedings for presenting their cases.

However (and although this can in no way be compared to the document production carried out under the disclosure phase of common law proceedings), Article 210 of the Italian Code of Civil Procedure provides that the judge, upon the request of a party, may order the other party or a third party to produce documents or evidence deemed necessary for the proceedings.

### iii Settlements

Generally speaking, the Italian Code of Civil Procedure provides that the judge, upon joint request of the parties, or by his or her own motion, may summon the parties to encourage them to settle the dispute.

In addition, as mentioned in Section II.ii, claims concerning insurance, banking and financial agreements are subject to the mandatory mediation procedure, pursuant to Article 5 of Legislative Decree No. 28/2010.

Furthermore, alternative dispute resolution mechanisms are provided by the applicable legislation. To elaborate on this point, in 2009 the Banking and Financial Arbitrator was established at the Bank of Italy, which is responsible for litigation concerning operations or banking and financial services with a maximum cap of €100,000.

The Banking and Financial Arbitrator operates through a board comprising five members: two members chosen by the Bank of Italy, one by the intermediaries’ associations, and by the associations representing the clients (business and consumers).

The decisions made by the board are not binding (as the judicial ones are), but the breach can be made public (e.g., on the Banking and Financial Arbitrator website). After the decision, the interested party may still resort to the ordinary court.

As of January 2017, retail investors’ claims against intermediaries’ breach of their duties of diligence, correctness, information and transparency in providing investment services or activities, may be brought before the Financial Disputes Arbitrator at CONSOB. The investor can file a petition with the Financial Dispute Arbitrator, if:

- **a** he or she has already sent a complaint to the intermediary;
- **b** the intermediary did not answer during the following 60 days;
- **c** no more than a year has passed after the complaint under point a above;
- **d** the requested amount by the intermediary is not higher than €500,000; and
- **e** there are no other alternative dispute resolutions pending with regard to the same facts.
The Financial Disputes Arbitrator operates through a board comprising the President, nominated by CONSOB, and four other members, two of which are appointed by CONSOB and two by the most representative consumers and intermediaries associations. After the decision of the board, the interested party may still resort to the ordinary court.

In March 2020, the Bank of Italy and CONSOB signed a memorandum of understanding to ensure cooperation between the Banking and Financial Arbitrator and the Financial Disputes Arbitrator.

As far as legal fees are concerned, Ministerial Decree No. 55/2014 sets forth certain guidelines for the quantification of the fees in litigation cases on a claim value basis. In the case of a dispute settlement, the value of the claim to be taken into consideration to quantify the legal fees shall be the value initially specified in the claim and considered at the initial time of the dispute, and not the sum actually obtained by the client, as recognised by the Supreme Court recently (judgment no. 20547/2019).

However, attorneys are free to agree with their clients fees that they deem more appropriate. Article 13, Paragraph 8, of Law No. 247, dated 31 December 2012, provides that in the event of settlement of a dispute by means of agreements made in any form, the parties shall be jointly and severally liable to pay compensation and reimburse expenses to all the lawyers engaged in the preceding three years and to outstanding creditors, unless they expressly waive the benefit of solidarity.

iv Damages and remedies

As a general rule, parties are allowed to seek compensation for the damages incurred. These damages should be calculated on the basis of the actual damage suffered, corresponding to the actual loss and loss of profit.

Punitive damages are not allowed in the Italian legal system. Nevertheless, a recent judgment of the Supreme Court (No. 16601/2017) ruled on the admissibility of the enforcement in Italy of punitive damages granted in foreign decisions, provided that the punitive damage cases are sufficiently predictable as well as the conditions in which it they might be awarded.

Apart from compensation for damages, parties can seek the following remedies:

a. voidance of the contract in cases of defects affecting the structure of the agreement;

b. annulment of the agreement in cases of fraudulent consent; and

c. termination of the agreements in cases of breach of the obligations specified therein.

III PUBLIC ENFORCEMENT

i Forms of action

As mentioned above, security claims may also be enforced by public authorities. In this area, the most relevant actions are those that may be taken by CONSOB and by the public prosecutor.

According to the Consolidated Law on Finance provisions, CONSOB and the public prosecutor shall cooperate and exchange information to facilitate the ascertainment of the violations perpetrated by the market players, including those considered non-criminal.

It is not uncommon, for administrative and criminal actions commenced by a public body such as CONSOB on the one side, and the public prosecutor on the other, to overlap. In such cases, the Consolidated Law on Finance provides that the criminal proceedings shall not be suspended and both administrative and criminal financial penalties may be imposed.
upon the same party for the same violation within specific thresholds set forth by the law. Such a mechanism has raised some concerns in recent years in terms of compliance with the ne bis in idem principle, as also made clear by the ECHR (see decision Stevens v. Italia, dated 4 March 2014), by the Constitutional Court (see Decision No. 102, dated 8 March 2016) and by the Court of Justice (see Decisions Nos. C-524/15, C-537/16 and C-596/16 merged with C-597/16).

The debate that developed around this topic ultimately led to the amendment of certain provisions of the Consolidated Law on Finance. Indeed, Legislative Decree 107/2018 now provides that if a proceeding – either criminal or administrative – is followed by a subsequent proceeding against the same (legal or natural) person and concerning the same breach, then the penalty shall be imposed upon the offender taking into account the punitive measures already taken as a result of the first proceeding and, in any case, within the limits of the part possibly exceeding the measure already taken as a result of the first proceeding by the administrative authority or by the judicial authority, as the case may be.

However, it has been noted that for the time being the legislative authority has not yet taken into consideration the fact that the violation of the ne bis in idem principle may in theory occur not only in cases of overlapping penalties, but also in the event of two different proceedings against the same (legal or natural) person actually overlapping.

Nevertheless, it has subsequently been clarified that Legislative Decree No. 107/2018 constitutes only a minimum intervention on the Consolidated Law on Finance text, and a later improvement cannot be excluded.

ii Procedure

The proceedings before CONSOB commence with the serving by the authority of a formal notice upon the involved party. Such a notice shall be served within 180 days of the assessment of the violation (such a term is extended up to 360 days when the communication is to be served outside the Italian Republic). The notice shall contain, inter alia, a reference to the supervisory activity carried out by the authority, a description of the alleged infringement and an indication of the provisions allegedly breached along with the relevant penalties.

Within 30 days of receipt of the notice, defendants may file briefs, documents and applications to access the official file or to ask to be personally heard about the alleged violations.

The competent office shall analyse the documents and draft a final report on the matter, also proposing the nature and measure of the sanction or the dismissal of the charges, to be forwarded to the defendant and to a specific CONSOB commission.

The defendants may submit their own written counter-arguments to the commission in response to the report.

The proceedings shall be concluded within 200 days, running from the 30th day after the date that the formal notice is served. This term may, however, be suspended in certain cases.

The decision shall include the adoption of penalties, dismissal of the charges or a proposal to apply a sanctioning measure falling within the competence of another administration or authority. The penalty measure is then communicated to the defendant and an extract is publicised in the CONSOB Bulletin.
The penalty measure can be challenged before the competent Court of Appeal within 30 days starting from the communication of the measure, or 60 days if the applicant resides abroad. The decision of the Court of Appeal can be challenged only within the limited scope of the correct application of the pertinent laws before the Supreme Court.

In recent years, some concerns have been raised in terms of potential violation of due process and the rights of defence of the defendant within the context of the public enforcement conducted by CONSOB. In that respect, however, it has been noted that the rights of defence as set out by the Italian Constitution should only refer to the jurisdictional proceedings and not to the administrative ones carried out by independent authorities, such as CONSOB.

In 2016, a new CONSOB Regulation entered into force that apparently further safeguards the rights of the party under investigation. However, there are still some issues to be tackled. By way of example, by order No. 117 dated 10 May 2019, the Italian Constitutional Court asked the Court of Justice to clarify whether the *nemo tenetur se ipsum accusare* principle, according to which no one is bound to incriminate or accuse himself, may also be claimed in the administrative proceedings handled by CONSOB.

To illustrate the procedure of criminal claims, the first phase (the investigation phase) is handled by the public prosecutor with the supervision of the judge in charge of the preliminary investigation. The claims are then assigned to the judge in charge of the preliminary hearings and, lastly, to the court.

The criminal prosecution is commenced with the public prosecutor entering the offence in the register of suspected crimes, opening a file against the indicted person.

During the investigation phase, the prosecutor, in cooperation with the criminal police, carries out, under the supervision of the judge in charge of the preliminary investigation, the necessary verifications in order to establish whether any clues that may lead to the exercise of the criminal action actually exist. This phase is largely covered by secrecy, unless the prosecutor needs to carry out the ‘guaranteed acts’, which cannot be performed without the participation of the indicted person and a lawyer.

Once the investigation phase is closed, the public prosecutor may ask the judge in charge of the preliminary investigation to dismiss the case, or that the case is brought to trial if the public prosecutor deems it has sufficient evidence to support the accusation in front of the judge in charge of the preliminary hearing. The judge in charge of the preliminary investigation may uphold the dismissal request or ask the public prosecutor to uphold the investigation, or even order the public prosecutor to seek criminal trial.

If the public prosecutor, either upon its request or abiding by the order of the judge in charge of the preliminary hearing, proceeds with the trial, the person under investigation shall be notified and shall take part in the preliminary hearing.

At the end of the preliminary hearing, the judge may decide to bring the case to trial, where the case is decided either by a sole judge or by a court comprising three judges.

The decision may then be challenged before the Court of Appeal and the Supreme Court within the limited scope of the review of the application of the laws.
iii Settlements

The Consolidated Law on Finance provides that some particular breaches referred to in Article 194-quinquies may be extinguished by paying, within 30 days of the serving of the notice letter from CONSOB (see Section III.ii), a sum equal to twice the minimum amount of the edictal penalty set forth by the law. However, the same offender may not take advantage of this if he or she has already benefitted from it in the previous 12 months.

As far as criminal proceedings are concerned, the Italian Code of Criminal Procedure provides the defendant with the possibility to reach an agreement with the public prosecutor, which may include the legal qualification of the conduct or the amount of penalties to be imposed. The agreement is then submitted to the judge presiding over the relevant phase of the proceedings and shall be considered as a standalone and overall proposal. The judge is granted significant powers, therefore, after reviewing the settlement reached in terms of, inter alia, adequacy of the penalty agreed therein, and on the legal qualification of the conduct he may dismiss the request if deemed inappropriate.

Note that the possibility to settle the criminal case has also been recently extended to the appeal phase. In particular, where the defendant has been convicted and has appealed the relevant decision, it may still reach an agreement with the public prosecutor and submit it to the judge of the appeal proceedings.

If a settlement is reached, the person possibly seeking damage compensation is entitled to commence civil proceedings. It is worth noting that, as the Italian legal system does not consider the settlement to be an admission of guilt of the judgment issued as a result of the plea bargaining procedure, case law has not yet taken a firm position on the probation value in compensation for damages in civil proceedings. However, the major guideline seems to be that of considering the settlement decision as an element freely appreciable by the civil judge. In this context, some rulings have gone so far as to affirm that, although the criminal judgment should be considered as an indication, the judge cannot disregard it without giving an explanation in the reasoning.

iv Sentencing and liability

The Consolidated Law on Finance provides for different penalties of criminal and administrative nature and sets forth the criteria to be considered to determine the type and the duration of the applicable penalties.

In particular, the competent administrative authorities (i.e., CONSOB or the Bank of Italy) shall take into consideration all the relevant circumstances, including, inter alia, the seriousness and length of the violation, the degree of liability, the extent of the advantage obtained, the prejudice caused to third parties and previous violations, if any.

However, in some specific cases regarding serious violations, such as insider trading or market manipulation, where penalties up to a maximum of €5 million may be imposed, the Consolidated Law on Finance establishes that the financial penalty may be increased by up to triple or up to 10 times the profit made or losses avoided as a result of the violation. Considering the aforementioned criteria and the entity of the profit of product of the offence, the standard financial penalties appear to be inadequate even when applied to the maximum.

As a general remark, the criminal court is allowed to apply the penalty in a discretionary manner, but taking into account some elements such as age or the significance of the offence, within the limits set by law and providing a reasoning along with the sentence.

With regard to the criminal penalties set forth by the Consolidated Law on Finance for insider trading and market manipulation, the above-mentioned law provides that the judge
may increase the financial penalties – usually ranging from €20,000 to €3 million and €5 million respectively – up to three times or up to the greater amount of 10 times the product of profit obtained as a result of the offence, when, due to the seriousness of the act, the personal qualities of the offender or the amount of the profit or product obtained from the offence, the penalties appear to be inadequate even if applied to the maximum.

IV CROSS-BORDER ISSUES

An action against a foreign issuer of securities may be brought before an Italian court by applying the provisions of Law No. 218/1995 (Italian private international law) or of EU Regulation 1215/15 (Brussels I-bis Regulation) if the foreign issuer resides in another EU member state.

According to these provisions, foreign issuers may be sued before Italian Courts:

a by way of a choice of forum agreement (Article 4 of Law No. 218/1995; Article 25 of Brussels I-bis Regulation);

b if the defendant has a registered office or a branch in Italy (Article 3 of Law No. 218/1995; Article 4 of Brussels I-bis Regulation) and if the Brussels I-bis Regulation applies;

c in matters related to tort, delict or quasi-delict, if the harmful event occurred or may occur in Italy (Article 7, Paragraph 3, of Brussels I-bis Regulation); and

d in matters related to a contract, if the obligation in question had to be performed in Italy (Article 7, Paragraph 1, of Brussels I-bis Regulation).

V YEAR IN REVIEW

In recent years, the relevance of and the attention to the security litigation field has increased. This consideration also derives from the transformed Italian economic scenario and from the growth of public listed companies.

Moreover, the establishment of the Banking and Financial Arbitrator and of the Financial Disputes Arbitrator has also granted minor investors the relevant dispute resolution tools.

Indeed, from the 2019 report of the Financial Disputes Arbitrator, evidence shows an increase in activity far beyond expectations, having received almost 1,678 petitions in a year.

The numbers are significant, because, on one hand, they show that the alternative dispute resolution mechanism is making its way in the security context and, on the other, that the security litigation market is growing.

Another significant datum that emerges from the report is that the majority of those who approached the Financial Disputes Arbitrator were natural persons assisted by legal practitioners. In the report presentation note, the President of the Financial Dispute Arbitrator considers this factor as depending on the relevance of the economic interests involved and the lack of financial knowledge that still characterises most of the Italian population.

In addition, it is worth mentioning that from the statutory perspective, progress is being made with reference to the efficiency of proceedings and to the safeguarding of the defence rights of the party involved.

On 5 December 2019, the Italian Council of Ministers approved the text of the bill to delegate the government to adopt legislative decree within one year to reorganise civil proceedings and amend the Italian Code of Civil Procedure.
In particular, the aim of the reform is to simplify and reduce the duration of the procedures, to improve the electronic court filing system, to use certified email as a means of service of process, and to fast track summary proceedings.

The reform may have a positive impact on securities civil litigation and on the settlement of relevant case law, especially related to unresolved issues.

However, as far as the civil and criminal procedure is concerned, at the time of writing, the covid-19 outbreak has forced the Italian government to adopt measures providing, inter alia, the suspension of civil and criminal proceedings from 9 March to 11 May, the postponement of all hearings after 11 May 2020 and the suspension of almost all procedural deadlines.

In addition, according to Law Decree No. 13, dated 9 April 2020, videoconference and written hearings will be introduced, almost certainly reshaping the ordinary procedure.

It will be worth considering how the above-mentioned proposed reform and, in general, judicial and non-judicial proceedings, will adapt to this emergency, in which alternative means offered by technology are becoming essential.

VI OUTLOOK AND CONCLUSIONS

In conclusion, there are still substantial procedural and crucial issues to be implemented and solved, but future reforms and the lively debate in jurisprudence and doctrine allow us to remain positive about the potential future improvement of the security litigation field.
Chapter 11

LUXEMBOURG

Frank Mausen, Paul Péporté, Thomas Drugmanne and Kristina Vojtko1

I OVERVIEW

i Sources of law

Given the high degree of harmonisation at the EU level regarding securities laws, the key sources of Luxembourg law in this area are mainly EU regulations, which are directly applicable in Luxembourg, and legal and regulatory texts that implement various EU directives into Luxembourg law. While Luxembourg’s legal regulatory framework for securities markets contains ever more European legislation, Luxembourg continually strives for innovation and attractiveness through its national initiatives.

Financial Sector Act

A central piece of legislation for the financial sector is the Luxembourg act dated 5 April 1993 on the financial sector (the Financial Sector Act) transposing many EU directives and regulations (including both the Markets in Financial Instruments Directive and Regulation). As such, the Financial Sector Act regulates various aspects of the securities markets, including authorisation requirements for regulated markets, trade transparency obligation for shares, rules on the admission of financial instruments to trading, requirements on product governance and independent investment advice, and duty to provide information and reporting to clients of the investment firms.

Market Abuse Regulation

Another important legislation is Regulation (EU) 596/2014 (the Market Abuse Regulation), which governs the prevention, detection, investigation and punishment of insider dealing. Besides prohibitions on insider dealing, the Market Abuse Regulation also incriminates market manipulation. Stabilisation measures, buy-back programmes and market soundings must also be analysed in light of the market abuse regime. The Market Abuse Regulation is complemented by Directive 2014/57/EU on criminal sanctions for market abuse (CSMAD). CSMAD, together with certain provisions of the Market Abuse Regulation, was implemented into Luxembourg law by the Luxembourg Act dated 23 December 2016 on market abuse (the Market Abuse Act), which replaced the initial market abuse act from 2006. The Market Abuse Act has confirmed the Commission de Surveillance du Secteur Financier

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(CSSF) as the competent authority for supervision of the compliance with market abuse rules in Luxembourg. It also deals with the reporting of infringements of Market Abuse Act requirements (including whistleblowing) and the related criminal law provisions.

**Prospectus Regulation**

Information requirements for prospectuses for public offers and admission of transferable securities to trading on a regulated market in Luxembourg are governed by Regulation (EU) 2017/1129 (the Prospectus Regulation). Certain provisions of the Prospectus Regulation (such as the designation of competent authorities, their powers, and the sanctioning regime) were implemented by the Luxembourg act dated 16 July 2019 on prospectuses for securities (the Prospectus Act).

**Transparency Act**

Issuers falling under the scope of the Luxembourg act dated 2008 (the Transparency Act) (which implemented European Directive 2004/109/EC dated 15 December 2004, as amended by Directive 2013/50/EU, on the harmonisation of transparency requirements into Luxembourg law) are obliged to disclose to the public their financial information, information on major holdings and information relating to general meetings and the exercise of voting rights. The latter requirement aims at ensuring equal treatment for all holders of securities that are in the same position.

**Other sources of securities law and soft law**

In addition to the above, there are various national laws that impact the Luxembourg securities markets. For instance, the amendments in 2016 to the Luxembourg act dated 1915 on commercial companies (the Companies Act) enabled additional types of companies to issue cleared and listed debt securities. These amendments have considerably increased the attractiveness of private limited liability companies as issuance vehicles. The Companies Act also sets out the rules governing bondholders meetings and managerial responsibility, as well as the rules for preparation of financial accounts and their approvals.

The Luxembourg act dated 6 April 2013 on dematerialised securities (the Dematerialisation Act) has modernised Luxembourg securities law by introducing a complete legal framework for dematerialised securities to keep pace with market developments. Accordingly, the dematerialised form of securities exists in addition to the traditional bearer and registered forms of securities. Dematerialised securities thus constitute a third type of securities, and an issuer will be free to choose from the three. The Dematerialisation Act does not provide for compulsory dematerialisation but for compulsory conversion if an issuer so decides.

The Luxembourg act dated 27 July 2003 relating to trust and fiduciary contracts, as amended (the Act on trust and fiduciary contracts) recognises trusts that are created in accordance with the convention on the law applicable to trusts and on their recognition made at The Hague on 1 July 1985 and that are legal, valid, binding and enforceable under the law applicable to the trusts.

The legal framework for securities is completed by Grand Ducal regulations and CSSF’s circulars and other guidance on a variety of specific topics. Also important are the rules and regulations of the Luxembourg Stock Exchange (the ROI). The ROI imposes certain obligations on issuers who have securities admitted to trading on a market operated by the
Luxembourg Stock Exchange. The ROI also gives power to the Luxembourg Stock Exchange to suspend or delist securities issued by issuers who do not comply with the provisions of the ROI.

ii Regulatory authorities

The competent authority for supervision of the securities markets, including their operators, and for investigations and enforcement of the securities laws in Luxembourg is the CSSF. It is responsible for the verification of compliance of financial information prepared by issuers of listed securities and monitoring of the disclosure obligations of such issuers, and it handles files relating to takeover bids and mandatory squeeze-out or sell-out.

The CSSF is also in charge of promoting transparency and fairness in the markets of financial products and services and is responsible for the enforcement of laws relating to financial consumer protection and the fight against money laundering and terrorist financing. The CSSF carries out its prudential supervision and supervision of the markets in order to contribute to the solidity and stability of the financial sector exclusively in the public interest. The CSSF falls under the authority of the Minister of Finance, but has financial autonomy and autonomy of action as required by international organisations.

The CSSF does not have the power to investigate and prosecute criminal offences. This falls within the sole remit of the criminal investigation police, state prosecutor and criminal courts.

The Commissariat aux Assurances is the Luxembourg authority competent for the supervision of the insurance sector.

iii Common securities claims

Neither the CSSF nor the administrative courts can rule on damages sought by a party that has suffered a loss. The claims for damages are decided solely by the civil courts, except in the case of criminal proceedings, where the victim of a criminal offence can choose to have them awarded by either the civil court or the criminal court.

The most common claims introduced in securities litigation to date are claims for false or misleading statements and omissions in prospectuses and consequential claims for the losses suffered as a result of breaches of the market abuse laws. The party suffering the loss may sue under contractual or non-contractual liability. There are also regular cases on shareholders litigation.

Generally, it is rather difficult in Luxembourg to be successful in secondary liability cases against service providers. For instance, in the case of the prospectuses required under the Prospectus Regulation or the Luxembourg Prospectus Act, the persons responsible for the information in the prospectus are clearly identified in the prospectus. It would, therefore, be difficult to successfully invoke the liability for misleading statement or omissions in a prospectus of additional third persons, even though involved in the preparation and distribution of the prospectus. However, service providers such as attorneys, auditors, financial intermediaries or underwriters can be held liable in the context of their contractual duties and undertakings and to the extent that they have participated in misrepresentations, omissions or other fraudulent conduct in relation to the offer and trade of securities. The most common claims in this respect are the claims of investors that have suffered a loss in relation to securities against their financial intermediary for breach of their professional duty to advise and fully inform the investors.
Companies or professionals subject to the CSSF’s oversight may also seek to hold the CSSF liable for damages for the choice and application of the means used to carry out the CSSF’s mission. The statutory non-contractual liability regime applicable for the CSSF presupposes gross negligence, which deviates from ordinary civil liability and allows damages to be sought for wrongdoing. This specific liability regime pertaining to the CSSF was challenged before the Constitutional Court as contrary to the constitutional principle of equality before the law. The Constitutional Court dismissed the claims and ruled in a judgment dated 1 April 2011 that the constitutional principle is not breached.

II PRIVATE ENFORCEMENT

i Forms of action

Luxembourg law does not have a specific statutory regime relating to prospectus liability or liability for misleading statements or the omission of pertinent information in an offer or a listing document. Consequently, prospectus liability claims are subject to the general provisions of liability of the Luxembourg Civil Code. On this basis, investors are typically seeking responsibility in securities actions on the ground of contractual or non-contractual liability.

The Luxembourg Prospectus Act provides that the issuer, the offeror, the person seeking admission to trading or the guarantor, as the case may be, shall be responsible for the information included in a prospectus. As mentioned in Section I.iii, a prospectus (prepared under the Prospectus Regulation or the Luxembourg Prospectus Act) must clearly indicate the persons responsible for the accuracy of the information contained thereunder. The prospectus must also include declarations by those persons that, to the best of their knowledge, the information contained in the prospectus is in accordance with the facts and that the prospectus makes no omission likely to affect its import. The prospectus summary and its translations do not entail civil liability, unless it is misleading, inaccurate or inconsistent, when read together with the other parts of the prospectus, or when it does not provide, when read together with the other parts of the prospectus, key information to aid investors when considering whether to invest in such securities.

Liability in contractual and non-contractual matters can only arise if a causal link can be established between the damage suffered by an investor and the event causing such damage. Investors would therefore have to prove that they suffered damage and that such damage is the result of a particular event (e.g., a breach of contract in contractual matters, or a misrepresentation in a prospectus causing a direct loss in an investment). Investors would furthermore have to prove that they relied on the relevant misrepresentation, omission or other fraudulent conduct. The persons responsible for the information included in a prospectus could therefore have a defence if they manage to establish that there is no causal link between the statements made in the prospectus and the loss suffered by a person.

Class actions

The Luxembourg New Code of Civil Procedure (NCPC) does not provide for the possibility to introduce class actions before the Luxembourg courts. It is, however, possible for several claimants with a common interest to bring a joint claim under certain circumstances.
ii Procedure
In Luxembourg, securities claims are not subject to a specific procedure or the jurisdiction of specific courts. Such claims are subject to standard civil or commercial procedure and to the jurisdiction of the general district courts sitting in civil or commercial matters. Decisions rendered by the district courts are subject to appeal before the Court of Appeal and decisions of the Court of Appeal may in turn be reviewed by the Supreme Court, which may only review questions of law, not factual matters.

Judicial proceedings before the district courts are initiated by a written petition. Defendants domiciled in Luxembourg are notified of the proceedings by a bailiff. The written petition must include, among other things, the names and full particulars of each party, the relevant court before which they should appear, a summary of the facts, the nature of the claim and the legal arguments of the claimant.

Written submissions of arguments are required when the judicial proceedings follow civil procedure, but the parties may rely on oral arguments before the lower courts and the district courts sitting in commercial matters. A claimant must be represented by a lawyer registered on list I of the Luxembourg Bar when the written procedure is followed (i.e., in civil matters). In oral proceedings, a claimant may be represented by any lawyer qualified to practice in Luxembourg or by certain persons who are not lawyers (e.g., family members).

Unlike common law jurisdictions, Luxembourg law does not provide for a discovery process and each party must file in due time the evidence it intends to rely on to justify its claim, in accordance with the adversarial principle. In certain circumstances, a party may request the judge to order the other party to disclose a specific document or information through summary proceedings. All documents filed by a party are communicated to the other party before the hearings. Documents and evidence may only be considered by the courts if they have been duly disclosed to the other parties before the hearings. The burden of proof lies on the party asserting a fact.

iii Settlements
From a Luxembourg law perspective, a settlement agreement is a contract between the claimant and the defendant to end an existing or future dispute between the parties. In principle, parties to civil liability proceedings, including public authorities, such as the CSSF, may decide to settle their dispute at any time, before or during judicial proceedings. The settlement agreement may (and ideally should) also provide for the settlement of legal or any other costs related to the dispute, although there are no specific rules in this respect. Once a settlement is reached, the parties can no longer take legal action regarding the points agreed under the settlement agreement, and the settlement agreement is considered as rei judicata of the last resort.

Court approval is not required, except in some limited situations: for instance, in case of settling by a bankruptcy receiver. A settlement agreement binds only the parties, and would therefore require mutual agreements that need to be identifiable between each of the claimants and the defendant in the case of joint proceedings with multiple claimants.
The CSSF is competent to act as an intermediary to seek amicable settlements between customers and credit institutions or finance professionals. In 2018, the CSSF closed 728 files relating to out-of-court dispute settlement, and in most cases the disputes were settled following the first instructions of the CSSF.2

iv Damages and remedies
Under Luxembourg law, a breach of contract or wrongdoing causing damages may entitle the injured party to obtain indemnification for the entire or actual loss suffered, provided that such loss is lawful, certain, direct and personal. If damages are caused by a breach of contract, the alleged damages should also have been foreseeable at the time of conclusion of the contract.

A wrongdoing may essentially fall into two major categories: wilful misconduct or unintentional misconduct. In the case of wilful misconduct, investors could seek damages calculated, for example, as the difference between the price of the securities and their value at the time of their purchase, had the misrepresentation not been made. Where investors could establish that they have entered into an agreement while relying on misrepresentations or incorrect statements, such agreement may be declared null and void (leading to the return of the parties’ original investment as though the agreement never existed). It may also be possible, in certain circumstances, for investors to argue that, as a result of a material misrepresentation, an agreement has been emptied of its substance or cause and to request the courts to rescind the agreement. In the case of unintentional misconduct, a distinction is generally made under Luxembourg law between a minor wrongdoing or gross negligence. There is no statutory definition of what constitutes a minor wrongdoing or gross negligence, and an assessment is therefore made on a case-by-case basis by the courts (it being understood that Luxembourg case law and legal literature are of the view that the assessment of wrongdoing as gross negligence should be made in a restrictive manner). A negligent misrepresentation in a prospectus could potentially fall within the category of unintentional misconduct. In the case of unintentional misconduct, investors would generally only receive damages, and an agreement could in principle not be declared null and void by a court.

Damages awarded to investors generally cover both the effective loss and the loss of profit. The assessment of the profits that an investor has been deprived of is delicate and must take into account the certainty of the loss. Luxembourg law does not provide for punitive or similar enhanced damages, so that under Luxembourg law, investors may only seek indemnification for actual losses.

III PUBLIC ENFORCEMENT

i Forms of action
The CSSF disposes of a broad range of significant measures to act against persons subject to its supervision that would either violate the applicable regulations or not comply with the professional obligations imposed on them. These measures are defined in specific securities laws and include administrative sanctions, such as administrative fines; disgorgement of the profits gained or losses avoided due to the infringement; withdrawal or suspension of the

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licence to conduct activities; and banning or suspension of individual activities (e.g., trading in securities). Some of the securities laws oblige the CSSF to publish the sanctions imposed on its website.

The CSSF also has various administrative measures that it can adopt to remedy the situation and to protect other participants of the securities markets. These include public warnings informing the public, in particular consumers, about the illegal activities in Luxembourg and the infringing party, and orders requiring the person responsible for the infringement to cease the conduct and to desist from a repetition of that conduct. In the case of non-compliance with disclosure obligations, the CSSF may publish information about the infringing party.

The CSSF does not have the power to investigate and prosecute criminal offences. This falls within the sole remit of the criminal investigation police, state prosecutor and criminal courts. Some infringements under the securities laws, in particular insider dealing, recommending or inducing another person to engage in insider dealing, unlawful disclosure of inside information and market manipulation under the Market Abuse Regulation, may amount to criminal offences. Similarly, under the Prospectus Act, an offer of securities to the public within the territory of Luxembourg without a duly approved prospectus in accordance with the provisions of the Prospectus Regulation is subject to administrative sanction. However, if carried out with intent, it will be re-qualified as a criminal offence. To this end, it is vital that the CSSF and the state prosecutor collaborate closely and exchange any information to avoid overlaps of proceedings and breaches of ne bis in idem principle. Detailed rules on cooperation have been included in this regard in the Market Abuse Act and Code on Criminal Procedure. These include, in particular, a requirement on the CSSF to inform the state prosecutor of the intention to open administrative proceedings. Following such notice, the state prosecutor may decide to initiate criminal prosecution. If the state prosecutor decides to prosecute, the CSSF must refrain from proceeding. Furthermore, if at any time during the administrative proceedings the CSSF becomes aware of indications of possible criminal offences, it must cease the proceedings and transmit the file to the state prosecutor.

In addition, and subject to the specific facts and circumstances of the matter, certain other general and specific criminal law related provisions under the Luxembourg Criminal Code and certain other particular statutory regimes could also apply to trigger criminal liability.

ii  Procedure
The administrative proceedings before the CSSF are governed by the Grand Ducal regulation dated 8 June 1979 on the procedure to be followed by administrations of the state and the communes (the Grand Ducal Regulation on Administrative Procedure). The general provisions of this regulation are further complemented by various more specific procedural rules included in the securities laws, for which the CSSF is appointed as supervisory authority.

The CSSF initiates enforcement actions either on the basis on the information gathered from its own monitoring (for instance, from analysing the periodic information submitted to it) or based on research through other information channels (such as consumer complaints, publicly available information or whistleblowing). The CSSF has broad investigatory powers and may access any data and documents in any form, recorded telephone conversations and emails. The CSSF can also request data traffic records from telephone operators or conduct
on-site inspections. The CSSF may exercise its investigative powers without prior judicial approval. A judicial approval for CSSF actions is only required in cases where the information request or inspection relates to an entity or individual that is not under its supervision.

Upon termination of an investigation process, the CSSF provides the persons concerned with an investigation report informing them of the envisaged decision and the information supporting its conclusions in line with the Grand Ducal Regulation on Administrative Procedure that specifically provides for the right to full access to administrative documents, the concerned party is provided with a complete file on their administrative situation. Together with the investigation report, the CSSF requests explanations or, where available, remedy measures to be taken. The investigation proceedings before the CSSF terminate with an administrative decision.

The CSSF does not review its administrative decisions and persons concerned must directly appeal to the administrative court of first instance, which undertakes a full review of the merits of the decision adopted by the CSSF. Representation by a qualified lawyer in the proceeding in front of the administrative court is mandatory. The decision at first instance is normally taken within seven months of proceedings commencement. Following a decision by the court of first instance, an appeal can be lodged with the administrative Court of Appeal. In appeal proceedings, the court generally hands down its judgment within five months of the judgment of the lower court. The appeal against the decision of the CSSF (in first or second instance) has no suspensive effect. The applicant has the possibility of requesting the president of the administrative court to suspend the execution of the contested decision or to impose a safeguard measure.

Criminal prosecution of securities-related enforcement actions is subject to the general principles of criminal procedure (no specific rules apply in this respect).

iii Settlements

There is no express legal provision providing for the possibility of settlement of administrative proceedings before the CSSF, although it may use its discretionary powers to determine the amount of an administrative fine or the severity of a sanction, following informal discussions with a supervised entity.

Settlement is, however, available in criminal proceedings, before a decision on the merits by the criminal chamber of the district court is reached. Settlement is only applicable for offences punishable by up to five years of imprisonment. A settlement must be reached within four months from the initial offer (it can be prolonged up to eight months). A formal refusal or failure to respond to an offer or counter-offer within one month renders the procedure null and void. The settlement is recorded in a settlement agreement, which among other things, must provide for agreed criminal sanctions, decision on the costs of the proceedings and damages to be paid (if any). The settlement agreement must be validated by a judge. If the judge refuses to validate the agreement, the settlement procedure is null and void (although this decision may be appealed). The settlement agreement does not impact actions in front of the civil courts. During the hearing on the validation of the settlement, injured

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3 The right to full access to administrative documents was confirmed by the Luxembourg courts. However, the courts have ruled that this right is not absolute and that the CSSF does not have an obligation to grant access to the entire file or to disclose information on all third parties involved or on its employees investigating the matters unless relevant for its decision (Cour Administrative 42666C, dated 11 April 2019).
parties may either accept the damages agreed in the settlement agreement or request that their claim be ruled by the civil chamber of the district court (although criminal procedure remains applicable).

iv Sentencing and liability
The CSSF has relatively broad discretionary powers when determining administrative sanctions. The range of applicable fines and available administrative measures depends on the relevant legal provision. The CSSF must also take into account all relevant circumstances of the party concerned, such as the gravity and duration of the infringement, the financial strength, the degree of responsibility of the person responsible for the infringement, the level of cooperation, and previous infringements or measures taken by the person responsible for the infringement, to prevent its repetition. Administrative fines and administrative sanctions may be imposed on legal and natural persons.

Criminal courts may condemn the defendant to imprisonment (in the case of natural persons) or corporate dissolution (in the case of legal entities) and/or impose a criminal fine, or both. Most of the criminal offences under the securities laws require intent. Attempted criminal offences are also punishable.

IV CROSS-BORDER ISSUES
In the event of a breach of applicable securities laws and regulations or a failure to observe instructions from the CSSF, the CSSF may bring enforcement action against entities under its supervision, including foreign ones. For instance, in a case of market abuse, the powers of the CSSF include any actions carried out in Luxembourg and abroad relating to financial instruments admitted to trading on a trading venue in Luxembourg or for which a request for such an admission has been made.

In international civil cases, the Luxembourg courts will have jurisdiction depending on the applicable international conventions and on the domicile of the parties. According to the provisions of Regulation (EU) No. 1215/2012 (Brussel I bis), the competent court to settle a tortious claim is the court of the EU Member State where the defendant has its domicile or the court of the EU Member State where the direct damage has occurred. Luxembourg courts would, therefore, be competent to settle a tortious claim against a defendant domiciled in another EU Member State brought by a person that suffered direct damage deemed to have occurred in Luxembourg.

Pursuant to Brussels I bis, Luxembourg courts have jurisdiction in civil and commercial matters when parties to an agreement have agreed to submit their disputes to the courts of Luxembourg. If the parties to an agreement have agreed to submit their disputes to the jurisdiction of a foreign court or to arbitration, Luxembourg courts would, in principle, have jurisdiction to order provisional measures in connection with assets or persons located in Luxembourg, and such measures would most likely be governed by Luxembourg law.

V YEAR IN REVIEW
On 21 July 2019, the Prospectus Regulation came into force and created, together with the Prospectus Act, a new prospectus regime in Luxembourg. Among other changes, various rules were adopted in the Prospectus Regulation to render the prospectuses more comprehensive for less sophisticated investors, who struggled to wade through very detailed information
under the former regime. On the national level, the liability regime remained unchanged and the Luxembourg legislator did not exercise the legislative option to include additional administrative sanctions or a higher level of pecuniary sanctions for breach of the obligations under the Prospectus Regulation.

To reflect on the changes introduced by the Prospectus Regulation and to revamp disclosure requirements for drawing up a prospectus for admission of securities to trading on the alternative market operated by the Luxembourg Stock Exchange (Euro MTF), the Luxembourg Stock Exchange adopted a new version of its ROI. The new ROI entered into force on 31 January 2020.

The year 2019 also saw the entry into force of the law dated 1 March 2019 (the Blockchain Act), which amended the Luxembourg act dated 1 August 2001 on the circulation of securities. The Blockchain Act modernised the current legal framework by specifying that securities may be booked and transferred through secure electronic recording devices, in particular through distributed ledgers such as blockchain.

Concerning the supervisory activities of the CSSF, the 2019 annual report is not yet available. The 2018 annual report of the CSSF indicates that the CSSF imposed only a few administrative sanctions and measures. For instance, in relation to notifications relating to major holdings under the Transparency Act, the CSSF imposed only one sanction and issued three warnings. The main infringements observed during the review of the notifications received by the CSSF consisted of late notifications or disclosure. The warnings, issued notably for late notifications, imply that the holder or issuer concerned will be monitored more strictly in relation to its notifications of major holdings for a period of 18 months. In 2018, an investigation of market manipulation in the form of wash trades (buy/sell transactions in financial instruments with no economic substance) led the CSSF to impose administrative fines on two investors (natural persons) to the maximum limit, amounting to €250,000. Moreover, two investigations (one into insider dealing and the other into market manipulation) have been closed without administrative fines or other administrative sanctions being imposed.

From the sanctions published on the CSSF’s website during 2019, it appears that the trend is consistent and that only a few sanctions have been imposed. These include four administrative fines in relation to breaches of the provisions of the Transparency Law (mainly relating to failure by issuers to publish their annual financial statements within the required time limit). The CSSF also published one administrative sanction in connection with a failure to comply with the obligations relating to the prevention and detection of market abuse under the Market Abuse Regulation.

There are no available statistics concerning criminal investigations and proceedings concerning securities markets.

VI OUTLOOK AND CONCLUSIONS

The financial sector plays a key part in Luxembourg’s economy, and the Luxembourg authorities (especially the CSSF) strive to find the right balance between increased supervision and the need for sufficient manoeuvring room to allow the financial sector to breathe and develop. The Luxembourg authorities recognise that the trend is towards a common supervisory culture and a harmonised application of a single rule book that deprives them of large parts of their flexibility in the regulation and supervision of the financial sector, which could have an impact on the number of sanctions being imposed on supervised entities.
To maintain the attractiveness of Luxembourg in a context where the regulatory framework becomes more and more harmonised, there are clear signals that the authorities want to differentiate themselves from their foreign counterparts by quality of service, responsiveness and approachability. They are putting a particular focus on maintaining Luxembourg’s role as a leading banking, fund and capital markets hub. For instance, the Ministry of Finance has relaunched the High Committee of the Financial Centre to create an institutionalised platform for the exchange of information between key stakeholders of the financial markets and the government, with a view to ensuring that Luxembourg stays at the forefront of economic and financial developments. Several working groups have been set up by the High Committee of the Financial Centre to modernise Luxembourg’s legal framework (including the banking, fund, fintech and securitisation legislation) to respond to the needs of the markets and their players. Despite the current focus by the Luxembourg authorities on the covid-19 crisis, we nevertheless expect that new and innovative legislation will be adopted in Luxembourg in the next year to ensure that Luxembourg maintains its status as a leading financial centre.
I OVERVIEW

i Sources of law

Federal acts
a Capital Markets and Services Act 2007 (CMSA);
b Securities Commission of Malaysia Act 1993 (SCMA);
c Securities Industry (Central Depositories) Act 1991 (SICDA); and
d Companies Act 2016 (CA).

Securities Commission codes and guidelines
a Equity Guidelines;
b Malaysian Code on Take-Overs and Mergers 2016;
c Rules on Take-Overs, Mergers and Compulsory Acquisitions (together with (b) above, the Take-Overs Code);
d Guidelines on Listed Real Estate Investment Trusts;
e Guidelines on Real Estate Investment Trusts;
f Guidelines on Exchange-Traded Funds;
g Guidelines on Unit Trust Funds;
h Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework; and
i Guidelines on Disclosure Documents, among others.

Listing requirements and business rules
a Main Market Listing Requirements (MMLR);
b ACE Market Listing Requirements (AMLR);
c LEAP Market Listing Requirements (LMLR, together with MMLR and AMLR, Listing Requirements); and
d Rules of Bursa Malaysia Securities Berhad (Business Rules).

Additionally, the respective regulatory authorities issue various practice notes, technical notes and rulings. Case law based on reported court judgments is also applicable.

Malaysia also has an offshore regime at Labuan, which has its own legislative and regulatory framework.

1 Wan Kai Chee is a partner and Tan Yan Yan is a principal at Rahmat Lim & Partners.
ii Regulatory authorities

a The Securities Commission of Malaysia (SC) is the main regulator in respect of securities laws in Malaysia.
b Bursa Malaysia Securities Berhad (Bursa Securities) is the approved stock exchange in Malaysia and regulates listed companies and other stakeholders.
c The Companies Commission of Malaysia (CCM) is the main regulator in respect of company laws in Malaysia. Local companies incorporated, and foreign companies registered, under the CA are subject to regulation by the CCM.

There may be certain matters related to securities that involve Bank Negara Malaysia, the central bank of Malaysia.

In relation to the offshore regime at Labuan, the main regulator is the Labuan Financial Services Authority.

iii Common securities claims

Common securities claims in Malaysia include:

a insider trading;
b submitting false or misleading statements to the SC or Bursa Securities;
c making false or misleading statements in a disclosure document or prospectus;
d stock market manipulation;
e causing wrongful loss to the listed corporation or any of its related corporations; and
f carrying on regulated activities without a capital markets and services licence.

The CMSA imposes onerous statutory liability on various parties, including the issuer, the bank or principal adviser, the reporting accountant and the lawyers involved in an offering of securities.

Under Section 248(1)(d) of the CMSA, a person who has suffered loss or damage resulting from a false or misleading statement in any disclosure document or prospectus may recover the amount of loss or damage from a person, other than the issuer, who was responsible for preparing the disclosure document or prospectus, or responsible for conducting the due diligence on the information or statement contained in the disclosure document or prospectus. This applies to the responsible person by whatever name called and may include the principal adviser or lead arranger. While there is a carveout in this provision for the issuer, there is a separate provision applicable to the issuer as well as various other specific parties.

Essentially, this provides direct recourse to investors against persons who are successfully established to be responsible for the loss or damage. The direct liability is subject to a due diligence defence. The context in which this arises is any case where a disclosure document or prospectus is issued (or is deemed to be), and these are mandatory in many cases.

II PRIVATE ENFORCEMENT

i Forms of action

Under the CMSA, an aggrieved investor may seek his or her own remedies against an alleged wrongdoer for market misconduct. Sections 199, 201, 210, 248, 249 and 357 of the CMSA provide that persons who have suffered loss or damage by reason of market misconduct under
securities laws may recover the amount of loss or damage by civil proceedings. These private remedies are available whether or not criminal prosecution has been instituted against the alleged wrongdoer for the offence committed.

In addition to statutory civil liability under the CMSA, Malaysian law continues to recognise common law duties and claims. Depending on the relevant circumstances, claims for negligence or misrepresentation may be available to investors. This means that in cases where it is unclear that investors have recourse against the alleged wrongdoer under the CMSA (which if available, may be a more straightforward claim), recourse under the common law may still be available.

In relation to market misconduct in respect of offer documents, due diligence is a statutory defence available to statutory civil and criminal liability under the CMSA. Under Section 250 of the CMSA, it is a defence against claims from persons to recover for loss or damage resulting from a false or misleading statement in a disclosure document or prospectus under Section 248 of the CMSA if the person shows that he or she had made all enquiries as were reasonable in the circumstances, and after making such enquiries the person had reasonable grounds to believe and did believe until the time of making the statement or provision of information that the statement or information was true and not misleading, or there was no material omission.

In relation to market misconduct in respect of listed securities, statutory defences that are available under the CMSA include the Chinese wall defence.

Class action is possible by way of representative action in Malaysia. Order 15, Rule 12 of the Rules of Court 2012 (ROC) provides for procedural requirements that apply to representative actions. Generally, three conditions must be met to initiate a representative action under Order 15, Rule 12 of the ROC:

1. the claimants are members of a class;
2. they have a common grievance or interest; and
3. the relief sought must be beneficial to all.

Representative action, however, is not a common choice of vehicle to facilitate securities claims in Malaysia, considering the high litigation costs involved and the rule against contingency legal fees.\(^2\)

In cases where market misconduct is committed against a company and the alleged wrongdoer has control over the board of directors of the company such that the company itself is unwilling to institute proceedings, the shareholders of the company may, with the leave of the court, institute a statutory derivative action under Section 347 of the CA on behalf of the company against the alleged wrongdoer. The test for leave under Section 347 of the CA is that the complainant is acting in good faith and it appears prima facie to be in the best interest of the company.\(^3\) The Malaysian courts, however, have applied a narrow interpretation for statutory derivative action. The leading authority in Malaysia is the Court of Appeal decision in Celcom (M) Bhd v. Mohd Suhaib Ishak [2011] 3 MLJ 636 (Celcom). In Celcom, the Court of Appeal held that leave to bring a derivative action must not be given lightly and a low threshold of merely determining if there existed a prima facie case is a wrong basis for granting leave. There is a lack of reported cases involving statutory derivative action.

\(^2\) Section 112 of the Legal Profession Act 1976.

\(^3\) Section 348(4) of the CMSA.
in Malaysia and this could be attributable to the high threshold for leave applied by the Malaysian courts and the fact that the company is the party that directly benefits from any remedy or award granted from the statutory derivative action.

ii Procedure
A civil proceeding may be commenced by the filing and service of a writ of summons (if there are substantial dispute of facts) or an originating summons (if there is unlikely to be any substantial dispute of facts). The claimant must state the material facts relied on, and the remedies claimed, in his or her pleadings. After pleadings are closed, the parties are subject to pretrial case management where the court will issue directions to prepare the matter for trial. Trial of the matter is then fixed, and after conclusion of the trial, the lawyers will prepare their submissions and reply submissions before a post-trial submission hearing is fixed. A judgment will then be delivered by the court.

The court can order discovery of documents that the party relies on or will rely on, or documents that could adversely affect the party’s or the other party’s case. In an application for discovery of documents, the application must specify or describe the documents sought for and show that the documents are relevant to the issue of the claim and the person against whom the order is sought is likely to have or have had them in his or her possession, custody or power.

iii Settlements
Generally, parties in civil actions may agree to settle based on their own terms. Order 22B of the ROC encourages parties to settle, as it imposes costs and interests penalties on a party for not accepting a settlement offer if the judgment is not more favourable than the terms of offer to settle.

In relation to claims against a licensed capital markets intermediary, the Securities Industry Dispute Resolution Centre (SIDREC) provides an avenue for an aggrieved investor who has a monetary claim not exceeding 250,000 ringgit. The SIDREC is a specialised dispute resolution body that facilitates prompt settlement of claims against certain licensed capital market intermediaries in relation to a dealing or transaction involving capital market products or services. The process generally involves mediation and, where necessary, adjudication. The mediator’s decision is binding on the licensed market intermediary. The claimant, however, may pursue his or her claim by civil proceedings if he or she is dissatisfied with the mediator’s decision.

iv Damages and remedies
Generally, damages for breach of contract and breach of statutory obligations under the CMSA are governed by the Contracts Act 1950 and the CMSA respectively. The basis of awarding damages for an action based on tort is to put the claimant in the position as if the wrong had not been done. In addition to payment of damages, the court may grant equitable remedies such as specific performance and injunction.

III PUBLIC ENFORCEMENT
i Forms of action
The SC may take any of the following enforcement actions:
Malaysia

a institute criminal prosecutions;
b institute civil proceedings; and
c issue administrative sanctions.

Criminal actions are pursued when the breach of securities laws significantly affects the market and where the alleged wrongdoer exhibited a significant degree of deliberateness or gross misconduct.4 Civil actions are pursued mainly to deprive the wrongdoers of illegally earned gains and to compensate investors.5 In certain circumstances, the SC initiates civil actions to obtain civil injunctions to prevent the dissipation of public listed companies’ assets resulting from market misconduct.6 Administrative sanctions are imposed for breaches that require immediate action and remedy.7 This includes the revocation and suspension of capital markets licence, reprimands and imposition of fines.

Bursa Securities may take enforcement action against a listed company and its directors and key officers, and an adviser for breach of the Listing Requirements. Bursa Securities may also take enforcement against a broker or other registered persons for breach of the Business Rules.

ii Procedure

Before the SC takes any enforcement action, it will carry out an investigation into the relevant act or omission that is contrary to the provisions under the securities laws. The investigation process generally involves gathering of documentary and oral evidence, including interviewing witnesses. The SC has wide investigative powers under the SCMA. For example, under Section 128 of the SCMA, the SC may search any person whom it has reason to believe has on his or her any object, article, material, thing, property, book, minute book, account, register or other document, including travel or other document, necessary, in the SC’s opinion, for the purpose of investigating any offence under any securities law. The SC may also require the surrender of any travel documents of the alleged wrongdoer pursuant to Section 132 of the SCMA.

Failure to cooperate with or obstructing an investigation officer of the SC in carrying out an investigation of a securities offence is a criminal offence.8

If the SC is satisfied that a case is made out against the wrongdoer, it will issue a show cause letter containing details of the SC’s findings to the wrongdoer. The show cause letter effectively gives the wrongdoer an opportunity to be heard before any enforcement action is taken by the SC. In practice, the wrongdoer is given 14 days (which may be extended at the SC’s discretion) to prepare his or her response, and the wrongdoer has the right to seek legal representation in preparing his or her response.9

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5 See footnote 4.
6 Section 317A of the CMSA.
7 See footnote 4.
8 Sections 128(7) and 134(5) of the SCMA.
9 See footnote 4.
Before Bursa Securities takes any enforcement action, it will conduct its own investigation into the possible breach of Listing Requirements or Business Rules. In the course of their investigation, where possible breaches of the CMSA or CA are found, Bursa Securities will refer the matter to the SC or the CCM, where applicable.

**Criminal prosecution**

Under Article 145(3) of the Federal Constitution of Malaysia, the Attorney General as the public prosecutor has the power, exercisable at his or her discretion, to institute, conduct or discontinue any proceedings for an offence. The SC, however, is empowered to institute criminal prosecution for offences under the CMSA, SCMA and SICDA with the written consent of the Attorney General.\(^\text{10}\) The SC’s prosecuting officers may conduct the prosecutions for such offences. In addition, the Attorney General has appointed some of the SC’s prosecuting officers as deputy public prosecutors to prosecute certain securities cases.\(^\text{11}\)

In a criminal prosecution, the defendant will be brought to court and asked whether he or she pleads guilty or not. If the defendant pleads guilty, there will be no trial and the court will pass sentence on the defendant. If the defendant pleads not guilty, the matter will proceed to trial.

Before commencement of the trial, the following information and documents must be delivered to the defendant:\(^\text{12}\)

\(a\) a copy of the information made under Section 107 of the Criminal Procedure Code relating to the commission of the offence to which the accused is charge, if any;

\(b\) a copy of any document that would be tendered as part of the evidence for prosecution; and

\(c\) a written statement of facts favourable to the defence of the accused signed under the hand of the person conducting the prosecution.

**Civil proceedings**

The SC may commence civil proceedings against the alleged wrongdoer, whether or not criminal prosecution has been instituted against the wrongdoer.\(^\text{13}\)

**SC administrative sanctions**

In determining the type of administrative sanction, the SC assesses the nature and severity of the breach, the conduct of the wrongdoer after the breach, and any previous regulatory record.\(^\text{14}\)

**Bursa Securities enforcement actions**

Where Bursa Securities proposes to take an enforcement action against a person under the Listing Requirements or Business Rules, it will serve the person a written notice specifying the nature and particulars of the breach the person is alleged to have committed. The person

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\(^{10}\) Section 375 of the CMSA, Section 136 of the SCMA and Section 61 of the SICDA.

\(^{11}\) See footnote 4.

\(^{12}\) Section 51A of the Criminal Procedure Code.

\(^{13}\) Sections 200(1), 211(1), 358(1), 360 and 361 of the CMSA.

\(^{14}\) See footnote 4.
may submit a written response to Bursa Securities' notice within the time stipulated in the notice. After conclusion of an enforcement proceeding, Bursa Securities will notify the person in writing of the decision.

Notwithstanding the above, Bursa Securities may initiate expedited enforcement proceedings against a person against whom enforcement action is proposed to be taken for prescribed breaches.

iii Settlements

Criminal prosecutions

The SC may, with the consent of the Attorney General, reach an agreement with the person who has committed a criminal offence. If the person pays the amount offered in the compound, no criminal prosecution will take place.\(^{15}\) The SC’s website lists the various criminal prosecution cases that it has compounded.

Civil proceedings

The SC may enter into legally binding settlements with the person who has contravened securities laws. The SC’s website lists the various regulatory settlements it has entered into with individuals and companies, in which civil claims are settled without admission or denial of liability.\(^{16}\)

Bursa Securities enforcement actions

In a full enforcement proceeding, a person in breach of the relevant provisions under the Listing Requirements or Business Rules may propose to enter into a settlement agreement with Bursa Securities, in which the parties will agree on certain facts, liability or penalty in respect of the breach.\(^{17}\)

iv Sentencing and liability

Criminal prosecutions

Breach of statutory obligations under the CMSA may attract the following criminal liability, among others:

\(a\) under Section 188 of the CMSA, if a person is guilty of an offence relating to insider trading, imprisonment for a term not exceeding 10 years and a fine of not less than 1 million ringgit;

\(b\) under Section 215 of the CMSA, if a person is guilty of an offence relating to submission to the SC of false or misleading statements, imprisonment for a term not exceeding 10 years and a fine not exceeding 3 million ringgit;

\(c\) under Section 246 of the CMSA, if a person is guilty of an offence relating to issuance of prospectus containing false or misleading statements or material omission, a fine not exceeding 3 million ringgit or imprisonment for a term not exceeding 10 years or both; and

\(^{15}\) Section 373 of the CMSA.


\(^{17}\) Bursa Securities Annual Report 2013.
under Section 317A of the CMSA, if a person is guilty of an offence relating to causing wrongful loss to the listed corporation or any of its related corporations, imprisonment for a term that shall not be less than two years but not exceeding 10 years and a fine not exceeding 10 million ringgit.

**Civil proceedings**

Under the CMSA, the SC is empowered to institute civil proceedings for any of the following court orders, among others, to:

a. recover an amount not exceeding three times the gross amount of pecuniary gain made or loss avoided and claim civil penalty up to 1 million ringgit;\(^\text{18}\)

b. recover an amount equal to three times the difference between the price at which the securities were acquired or disposed of, or agreed to be acquired or disposed of, by the insider or the other person, and the price at which they would have been likely to have been acquired or disposed of at the time of the acquisition or disposal or agreement, as the case may be, if the information had been generally available, and claim civil penalty up to 1 million ringgit;\(^\text{19}\)

c. recover the amount of loss or damage on behalf of persons who suffered loss or damage by reason of the conduct of another person who has contravened any provision of Part VI of the CMSA or any regulations made under the CMSA;\(^\text{20}\)

d. direct the person in breach to comply with the provisions under the Take-Overs Code;\(^\text{21}\) and

e. remove or bar a chief executive or director from being a chief executive or director of any public company for a period of time.\(^\text{22}\)

**SC administrative sanctions**

Under the CMSA, the SC may impose any of the following administrative sanctions, among others:

a. direct the person in breach to comply with the relevant securities laws;\(^\text{23}\)

b. penalty in proportion to the severity or gravity of the breach up to 1 million ringgit;\(^\text{24}\)

c. reprimand;\(^\text{25}\)

d. require the person in breach to take such steps as the SC may direct to remedy the breach or to mitigate the effect of such breach, including making restitution to any other person aggrieved by such breach;\(^\text{26}\)

e. in the case of a breach of Part VI of the CMSA or guidelines issued pursuant to Part VI of the CMSA, refuse to accept or consider any submission under Part VI of the CMSA.\(^\text{27}\)

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18 Sections 200(2) and 211(1) of the CMSA.
19 Sections 201(5) and (6) of the CMSA.
20 Section 358(1) of the CMSA.
21 Section 220(3) of the CMSA.
22 Sections 318 and 360 of the CMSA.
23 Sections 354(3)(a) and 356(2)(a) of the CMSA.
24 Sections 354(3)(b) and 356(2)(b) of the CMSA.
25 Sections 354(3)(c) and 356(2)(c) of the CMSA.
26 Sections 354(3)(d) and 356(2)(d) of the CMSA.
27 Section 354(3)(e) of the CMSA.
in the case of promoters or directors of a corporation, in addition to the actions that may be taken under paragraphs (a) to (e) above, impose a moratorium or prohibition against trading and dealing in securities, or issuing a public statement that the retention of office by the director is prejudicial to the public interest; or

in the case of licensed capital markets intermediaries, refuse renewal of their licence, or revoke or suspend their licence.

**Bursa Securities enforcement actions**

Under the Listing Requirements, the enforcement actions that Bursa Securities may take include:

a reprimanding privately or publicly;
b imposing a fine of up to 1 million ringgit;
c suspending the trading of listed securities; and
d delisting a listed corporation.

Under the Business Rules, the enforcement actions that Bursa Securities may take include:

a reprimanding privately or publicly;
b imposing a fine of up to 1 million ringgit;
c suspending the right to trade; and
d removing a person from the register.

**IV CROSS-BORDER ISSUES**

Under the MMLR and AMLR, a foreign corporation seeking or having a primary or secondary listing on Bursa Securities is required to establish, among other things, a share transfer or share registration office in Malaysia, and appoint an agent or representative in Malaysia to be responsible for communication with Bursa Securities, on behalf of the foreign corporation. Under the CA, a foreign corporation that has established a share transfer or share registration office in Malaysia is required, among other things, to register as a foreign company with the CCM, have a registered office within Malaysia and file certain prescribed information with the CCM. The satisfaction of the requirements for a foreign corporation to be listed in Malaysia would facilitate the service of a writ or an originating summons to the listed foreign corporation.

The SC is a signatory to the IOSCO Multilateral Memorandum of Understanding (the IOSCO Multilateral MOU) and to many bilateral memoranda of understanding with its counterparts in other countries. The SC has continuously sought investigative assistance from foreign supervisory authorities under the IOSCO Multilateral MOU. In 2019, the SC made 28 requests to 12 foreign supervisory authorities, mostly to seek assistance to record

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28 Section 354(3)(f) of the CMSA.
29 Sections 64 and 65 of the CMSA.
30 Section 72 of the CMSA.
witness statements and obtain documents related to banking and securities transactions. \(^{33}\) Conversely, during the same year, in response to 10 requests for investigative assistance, the SC rendered assistance to five foreign supervisory authorities. \(^{34}\)

In addition, under Section 150 of the SCMA, the SC may, upon receiving a written request from a foreign supervisory authority for assistance into an alleged breach of a legal or regulatory requirement, offer assistance to the foreign supervisory authority by carrying out investigation of the alleged breach or providing such other assistance as it sees fit. The SC’s authority under Section 150 of SCMA extends to the conduct in question constituting a breach of Malaysian or foreign securities laws.

V YEAR IN REVIEW

i Significant decisions

*Maybank Trustees Berhad v. AmTrustee Bhd & Others & Other Cases [2019] MLRAU 310*

On 18 September 2019, the Court of Appeal upheld the High Court decision in *AmTrustee Bhd & Others v. Aldwich Bhd (in receivership) & Others [2018] 7 MLJ 152 (Aldwich)*.

On 24 July 2017, the High Court found in favour of a group of bondholders in their various claims based on statutory liability and common law against the issuer (Aldwich Bhd), the issuer’s holding company, a substantial shareholder of the issuer and its holding company, the bank acting as among others, the adviser and lead arranger, facility agent and security agent, the trustee and the reporting accountant.

In the *Aldwich* case, the issuer’s holding company transferred its business, assets and operations related to catalyst recovery and waste oil refinery (WOR) to the issuer to raise funds through the issuance of bonds to finance the construction of a WOR. Under the bond structure, the bonds were secured over the issuer’s assets and subject to a ring-fencing mechanism to mitigate the bondholders’ risk of non-repayment of the bonds. Under the ring-fencing mechanism, among others, business contracts of the issuer were supposed to be assigned to the bank and cash flow proceeds generated from the issuer’s business were supposed to be credited into the revenue account controlled by the bank. Instead, most of the business contracts of the issuer’s holding company were not novated or assigned to the issuer nor subsequently assigned to the bank, and the issuer’s holding company received the proceeds under such contracts.

This, among other things, caused the disclosures relating to the bond structure in the offer document, to be incorrect.

In the course of arguments for the case, the High Court had to consider whether the bank could rely on the disclaimer for liability contained in the offer document, in light of the statutory restriction that strikes down any disclaimers against statutory liability under the former Section 65 of the SCMA (which has since been replaced with Section 256 of the CMSA) and the Federal Court decision in *CIMB Bank Bhd v. Maybank Trustee Bhd & Other Appeals [2014] 3 CLJ 1 (Pesaka Astana)*.

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\(^{34}\) SC Annual Report 2019.
The High Court held that while the statutory restriction under the current Section 256 of the CMSA has no retrospective effect, the Federal Court judgment in the Pesaka Astana case on the effect of the disclaimer was not relevant and was distinguishable. Among the statements made were the following:

...the Federal Court however did not go on to state how the parties were bound by the disclaimer in the important notice if the IM was not an agreement/contract and that the reasoning of the Federal Court disregarded or omitted two fundamental principles relating to exclusion clauses:

(i) an exclusion clause can only be effective if it is incorporated into a contract. Absent a contract, it is not binding; such clauses do not exist in a vacuum but they are consensual in nature; and

(ii) an exclusion clause is to be construed strictly against the party which is relying on it. It cannot exclude liability unless it is expressed in clear terms by reason of the 'contra proferentum' rule...

...applying these settled principles of contractual exclusion clauses it would mean that if, on the one hand, the IM, which is the only document that contains the disclaimer of liability, is not an 'agreement' to which it was a party, [the bank] cannot rely on it because it is not consensual between [the bank] and the plaintiffs. If, on the other hand, the IM containing the said important notice is an 'agreement', then by virtue of s 65 of the SC Act and/or s 256 of the CMSA it is void. In either situation, the Pesaka (FC) judgment is with respect not relevant.

The Court of Appeal distinguished the Pesaka Astana case from the Aldwich case on the basis that the bondholders' cause of action in the present case was founded not on the disclaimer [or a cause of action relevant to it] or that the offer document was a contractual document. Instead, it was based on the statutory claim that the offer document contained false or misleading statements or failed to disclose information that amounted to material omissions. The Court of Appeal held that giving effect to the disclaimer 'would have the effect of rendering the statutory provisions of the [SCMA] nugatory and impotent'. The Court of Appeal made the following statements, among others:

It cannot have been the intention of the Parliament that the protection of these provisions of the [SCMA] could be circumvented by the insertion of a mere disclaimer, no matter how widely worded it might be… It is both untenable or inconceivable that a disclaimer such as the important statement in the IM can be construed or utilised to protect or absolve: (a) a deliberate act or misrepresentation; or (b) a deliberate misleading or false statement, occasioned by the wilful non-disclosure of material information.

SC v. Chan Soon Huat [2018] 9 MLJ 782

On 24 January 2018, the High Court found that the SC had successfully proven its claim against Chan Soon Huat (Chan SH), a former founder and director of WCT Berhad (WCT), for insider trading. The High Court found that Chan SH had disposed of his shares in WCT while in possession of inside information. Chan SH was ordered to pay the claimed sum of 3,238,760.55 ringgit, which is equivalent to three times the difference between the price at which the securities had been disposed of and the price at which the securities would have been likely to have been disposed of at the time of the disposal, if the material non-public information had been generally available; and a civil penalty of 500,000 ringgit.
ii SC enforcement actions

Based on the SC Annual Report 2019, the SC took the following enforcement actions in 2019:

<table>
<thead>
<tr>
<th>Item</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Criminal charges laid</td>
<td>1</td>
</tr>
<tr>
<td>Administrative sanctions imposed</td>
<td>99</td>
</tr>
<tr>
<td>Infringement notices issued</td>
<td>99</td>
</tr>
</tbody>
</table>

As at 31 December 2019, there were 48 active investigations and 34 ongoing cases comprising 12 criminal prosecutions and 22 civil proceedings.

Infringement notices are issued where breaches of securities laws do not warrant any formal enforcement action or administrative sanction. These include supervisory letters, warning letters, non-compliance letters and cease-and-desist letters.

VI OUTLOOK AND CONCLUSIONS

As a result of the global covid-19 outbreak that has disrupted global economic activity, companies in various industries have been impacted. It is expected that many borrowers could default under debt securities or other borrowings, and recovery litigation will increase in the near future.
I OVERVIEW

i Sources of law

The primary source of securities law in New Zealand is the Financial Markets Conduct Act 2013 (FMCA). The FMCA is the culmination of a comprehensive reform of securities law in New Zealand, and entirely replaces the pre-existing regime.

The FMCA, together with the common law and other consumer protection legislation, provides the key source of law for securities litigation. Regulations promulgated under the FMCA also contain important detail relevant to the securities regime.

New Zealand’s main securities exchange is the New Zealand Stock Exchange (NZX). The NZX Listing Rules and NZX-issued guidance are an important source of market regulation.

ii Regulatory authorities

The Financial Markets Authority Act 2011 (FMAA) establishes the Financial Markets Authority (FMA), which is New Zealand’s financial conduct regulator and provides licensing, compliance, supervision and systems oversight under a number of statutes, including the FMCA.

The FMCA and FMAA provide the FMA with a number of administrative, civil and criminal tools – escalating in severity and formality – to engage with market participants, with a focus on proportionality. The FMA has increased staff numbers and significantly increased budget over its predecessor, the Securities Commission, such that it has the resources to focus on market integrity and conduct.

1 Chris Curran, Marika Eastwick-Field and Nathaniel Walker are partners at Russell McVeagh. The authors wish to thank Hannah Bain, Fayez Shabaz, Nicole Browne and Briana Walley for their assistance.
2 Other relevant legislation includes the Financial Markets Authority Act 2011; the Companies Act 1993; the Fair Trading Act 1986; and the Credit Contracts and Consumer Finance Act 2003.
3 See, for example, the Financial Market Conduct Regulations 2014.
5 In 2019, the FMA had 212 staff and a budget of NZ$38 million (see https://www.fma.govt.nz/assets/Annual-reports/FMA-2019-Annual-Report.pdf (FMA Annual Report); https://www.budget.govt.nz/budget/pdfs/estimates/v1/est19-v1-buscin.pdf (Vote Business, Science and Innovation 2018)).
The New Zealand Markets Disciplinary Tribunal (the Tribunal) is a regulatory body, separate to the NZX, which undertakes an essentially judicial role to determine whether breaches of the NZX Listing Rules have occurred and, if so, what consequences should follow (e.g., to revoke or suspend a market participant’s designation or issue a penalty).6

**iii Common securities claims**

Although relatively few proceedings have been brought under the FMCA since its enactment, these cases are beginning to increase in volume.7 In addition, there is an existing body of case law applying the preexisting statutory regime (the Securities Act 1978 (SA) and the Securities Markets Act 1988 (SMA)),8 which, together with Australian decisions, provide guidance on the interpretation and application of the FMCA.

The most significant example of private securities litigation in New Zealand is that of *Houghton v. Saunders*, involving representative claims (primarily under the SA) by shareholders of Feltex Carpets Limited against parties associated with that failed company.9

**False or misleading statements and omissions in disclosure**

A focus of the liability regime under the FMCA (as was the case under the SA) is on defective disclosure in offer documents.10 One of the key prohibitions in the FMCA is on the offeror11 making or continuing to make an offer where the product disclosure statement12 or register entry for a financial product contains false or misleading information, or omits required

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6 See https://www.nzx.com/regulation/nzmd-tribunal-regulation; the Tribunal is not responsible for identifying (potential) breaches, as that responsibility lies with the NZX itself. The NZX has dedicated teams for this purpose.

7 See, for a recent example, civil proceedings brought against CBL Corporation Limited and its directors for, inter alia, breaches of the FMCA. Two of those proceedings were brought by the FMA and the remaining two were brought by separate litigation-funded class actions. Further discussion of these proceedings is set out in the Year in Review section.

8 See, for example, *R v. Moses HC Auckland CRI-2009-004-1388*, 8 July 2011; *R v. Graham* [2012] NZHC 265; *Jeffries v. R* [2013] NZCA 188; *Graham v. R* [2014] NZSC 55; *Houghton v. Saunders* [2014] NZHC 2229; [2015] NZLR 74 (*Houghton* (HC – substantive)); *Houghton v. Saunders* [2016] NZCA 493, [2017] 2 NZLR 189 (*Houghton* (CA)); and *Houghton v. Saunders* [2018] NZSC 74 (*Houghton* (SC)). There is still the potential for securities claims under the SA for securities issued under that regime (issuers of securities could choose to make an offer pursuant to the SA (notwithstanding its repeal) within two years (in the case of continuous issue securities) or 12 months (in any other case) from the commencement of the FMCA. (See FMCA, Schedule 4, Clauses 5–6). The limitation period for actions under the SA is generally six years, so proceedings with respect to certain offerings could still be brought pursuant to the liability regime in the SA until at least 2022.

9 *Houghton* (HC – substantive), note 8. The High Court of New Zealand in 2014 found in favour of the defendants. The Court of Appeal in turn upheld the High Court judgment: *Houghton* (CA), note 8. The Supreme Court, however, allowed the appellant’s appeal to a limited extent and has left the questions of reliance, loss and defences for resolution at a stage 2 hearing: *Houghton* (SC), note 8.

10 Sections 82, 99 and 427 of, and Clause 27 of Schedule 1 to, the FMCA.

11 The ‘offeror’ for securities on issue is the issuer.

12 The product disclosure statement (PDS) is the New Zealand equivalent of an investment statement. The PDS is a consumer-focused disclosure subject to page limits, and is supplemented by disclosures on an electronic register.
information, or a new circumstance has arisen since the launch of the offer that has not been disclosed (in each case if the relevant matter is materially adverse from the point of view of the investor). Where this prohibition is contravened:

\[ a \] the offeror will have strict civil liability for the contravention;
\[ b \] each director of the offeror at the time of the contravention will be deemed to have contravened the provision and will have strict civil liability;
\[ c \] the offeror and its directors can be criminally liable for a knowing or reckless contravention; and
\[ d \] others (e.g., joint lead managers, underwriters and professional advisers) can have civil liability for ‘involvement’ in the contravention (or criminal liability as a party to offending).

There is also a presumption of loss, meaning that if a person acquires financial products that have declined in value following a contravention of the above prohibition, the person must be treated as having suffered loss or damage because of the contravention. A defendant can rebut this presumption through proof that the decline in value was caused by something other than the relevant statement or omission. There is no separate requirement under the FMCA that a plaintiff demonstrate reliance.

The FMCA contains a number of statutory ‘due diligence’-style defences for contraventions of civil liability provisions, including in relation to defective disclosure. Relevant defences include:

\[ a \] that the contravention was because of reasonable reliance on information supplied by another person;
\[ b \] that all reasonable enquiries were made and that, after making such enquiries, the defendant believed on reasonable grounds that the statement was not false or misleading or that there had been no omission, or the defendant was unaware of the new circumstance; and
\[ c \] in respect of directors who are deemed to have contravened, or persons ‘involved’ in a contravention, that they took all reasonable and proper steps to ensure that the offeror complied with its obligations.

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13 FMCA, Sections 82 and 101.
14 FMCA, Section 534.
15 FMCA, Section 510.
16 FMCA, Section 533.
17 Crimes Act 1961, Section 66. There is also a separate criminal offence under Section 512 of the FMCA, under which any person will be criminally liable if, with respect to a document required by or for the purposes of the FMCA, they make or authorise the making of a statement in that document that is false or misleading in a material particular, knowing it to be false or misleading.
18 FMCA, Section 496. This presumption applies in relation to defective disclosure under Sections 82 and 99 of, or Clause 27 of Schedule 1 to, the FMCA.
19 FMCA, Section 496.
20 FMCA, Section 499. Note that ‘another person’ does not include a director, employee, or agent of the party in contravention.
21 FMCA, Section 500.
22 FMCA, Sections 501 and 503.
Fair dealing provisions

The fair dealing provisions in the FMCA prohibit, generally, misleading or deceptive conduct in relation to financial products and services.23 The making of unsubstantiated representations in relation to financial products or services is also prohibited.24

The fair dealing prohibitions apply broadly to all financial products and services, not just regulated offers. The fair dealing provisions do not apply to conduct that contravenes more specific prohibitions in the FMCA (e.g., in relation to defective offer documents),25 but can apply to other materials, for example, advertisements or road show presentations, and to advertising material for non-regulated offers.

Market manipulation and insider trading

Civil or criminal liability can be imposed for market manipulation or insider trading. The market manipulation prohibitions in the FMCA apply to any quoted financial product, and focus on disclosure-and trade-based manipulation.26 Disclosure-based manipulation consists of disseminating false or misleading information calculated to materially affect the price or to induce a person to trade in the financial product.27 The claimant must show that a material aspect of the information disseminated was false or misleading and that the defendant knew, or ought to have known, that this was the case.28

Trade-based manipulation involves an act or omission that will have, or is likely to have, the effect of creating a false or misleading appearance of the extent of active trading or the market for a financial product.29 The defendant must know or ought to have known that their act or omission will, or is likely to, have such an effect.30 A defence exists if the defendant can prove that the trading or offer to trade in financial products was in line with market practice and for a proper purpose.31 The FMCA deems ‘wash sales’ and ‘matched orders’ to constitute manipulation.32

An ‘information insider’ under the FMCA is someone with information not generally available to the market who knows or ought to know that the information is material and not available to the market.33 An information insider is prohibited from direct trading, disclosing

23 FMCA, Sections 17–38.
24 FMCA, Section 23. Note this prohibition does not apply to the content of offer documents – Section 26 of the FMCA.
25 FMCA, Section 28.
26 FMCA, Sections 240–269.
27 FMCA, Section 262.
28 FMCA, Section 262.
29 FMCA, Section 265.
30 FMCA, Section 265.
31 FMCA, Section 268.
32 FMCA, Section 267.
33 FMCA, Section 234.
information to others who are likely to trade, or advising or encouraging others to trade in the relevant financial product.\textsuperscript{34} The FMCA and regulations provide exemptions to the insider trading prohibitions.\textsuperscript{35}

**Tort**

It is not settled in New Zealand whether a duty of care in tort is owed to investors for the content of financial product disclosure and advertisements. In *Houghton v. Saunders*, the High Court held there was no special relationship for the purposes of a negligence claim because issuers’ and promoters’ obligations to the plaintiffs were already defined by the existing statutory scheme (the SA).\textsuperscript{36} The negligence claim was abandoned on appeal.\textsuperscript{37}

**Secondary liability and gatekeepers**

Other than in respect of the offeror and its directors, civil liability under the FMCA for defective disclosure will turn on whether a person was ‘involved in the contravention’.\textsuperscript{38} In criminal securities proceedings, secondary liability will turn on the party liability provision in the Crimes Act 1961 (Crimes Act).\textsuperscript{39}

A person is involved in a contravention if they aid, abet, counsel, procure, induce (by threats or otherwise), are knowingly concerned in (directly or indirectly), or have conspired with others to effect the contravention.\textsuperscript{40} The secondary liability provisions are similar to those in at least two existing New Zealand statutes, Section 43(1) of the Fair Trading Act 1986 (FTA) and Section 83 of the Commerce Act 1986, and Australian legislation, all of which will be helpful to practitioners applying them in practice.\textsuperscript{41} The category most open to debate is the threshold of being ‘knowingly concerned’ in a contravention. Issues will arise as to what form of knowledge is required and what a person must have knowledge of (i.e., the essential facts that constitute the contravention). The provision could, potentially, capture anyone engaged in the offer process, whether they are a joint lead manager, underwriter or any other third party in the preparation of the disclosure. Liability will depend on the particular facts as to whether the relevant person was involved in the contravening conduct and had knowledge of the essential matters comprising a contravention.\textsuperscript{42} This will be, ultimately, a question of fact and degree in each case, and could be particularly difficult to determine where the underlying contravention involves evaluative judgments as opposed to simple untruths.

\textsuperscript{34} FMCA, Sections 241–243.

\textsuperscript{35} FMCA, Sections 245–256. These circumstances include where trading is required under an enactment; where the disclosure of information is required in the preparation of a PDS or other offer document; trading with knowledge of the trader’s own intentions (for example, dealing in products of a target company prior to a takeover); and executing trades on specific trading instructions.

\textsuperscript{36} *Houghton* (HC – substantive), note 8; and see also *Tait v. Austin* (2000) 8 NZCLC 262,167 (HC).

\textsuperscript{37} *Houghton* (CA), note 8, at [34].

\textsuperscript{38} FMCA, Section 533. Directors, officers and other participants could also face direct liability for other common law (e.g., tort) and statutory claims (e.g., breach of directors’ duties), as well as direct criminal liability under the Crimes Act, which is preserved by Section 542 FMCA.

\textsuperscript{39} Crimes Act 1961, Section 66.

\textsuperscript{40} FMCA, Section 533 defines the term involved in a contravention.

\textsuperscript{41} See, for example, *Yorke v. Lucas* (1985) 158 CLR 661 and *Ng v. Harkness Law Ltd* [2015] NZCA 411.

\textsuperscript{42} For example, assisted in preparing the PDS.

\textsuperscript{43} For example, knowledge that a statement in a PDS was misleading.
II PRIVATE ENFORCEMENT

i Forms of action

In addition to private individual actions, securities litigation can take the form of representative actions and shareholder derivative actions.

Representative actions

Until recently, representative actions had not been a significant feature of New Zealand’s legal landscape. One reason for this slow development is the current absence of clear rules for such litigation.44 Despite the lack of a developed statutory framework, a group can bring litigation by way of representative proceedings action under the High Court Rules (HCR).45 Significant litigation has been brought in this way,46 and there has been a notable rise in representative proceedings in recent years particularly in 2019.47 The HCR provide that a person may sue ‘on behalf of, or for the benefit of, all persons with the same interest in the subject matter of a proceeding’, with the consent of the represented parties or as directed by the court on application.48

Securities representative actions in New Zealand will likely see continued growth in the future as a result of the presumption of loss in the FMCA, which will make it easier to establish causation in actions by the FMA and other plaintiffs on behalf of a large number of investors.

Derivative actions

Shareholders can also bring derivative actions under the Companies Act 1993 (CA).49 Shareholders can seek leave from the court to bring a claim in the name, and on behalf, of the company. Typically, proceedings of this nature are brought against company directors in respect of breaches of directors’ duties.

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44 In 2008, the Rules Committee released a draft Class Actions Bill and Rules for consultation. Although the Commerce Committee recommended in 2012 that the Government give priority to the introduction of a class actions regime, no real progress was made until a reference to the Law Commission in 2017. In 2018, the Law Commission announced it would review both class actions and litigation funding and, in December 2019, it released its terms of reference. The Law Commission intends to publish a detailed consultation document in 2020 and will report to the Minister with its recommendations by the end of 2021. At the time of writing, no consultation document has been published. See https://www.lawcom.govt.nz/our-projects/class-actions-and-litigation-funding.
45 HCR, Rule 4.24.
46 See, for example, Houghton (HC – substantive), note 8, as well as the discontinued proceedings against various retail banks in respect of bank fees.
47 Claims launched recently include: a claim by insurance policyholders against an insurer in relation to insurance recoveries following the Canterbury earthquakes (2018); claims by investors in a failed asset management company against a major retail bank for its role as banker to that asset management company (2019); claims by home/building owners against manufacturers in relation to defective cladding products (one filed in 2015 and another announced 2019); and two class actions brought under the FMCA against CBL Corporation Limited and its directors (2019).
48 HCR, Rule 4.24.
49 CA, Section 165.
ii Procedure

The procedural features of a private securities claim are largely governed by the HCR, which, alongside the Senior Courts Act 2016, form a procedural code.\(^{50}\) Private proceedings under the FMCA are ordinary civil proceedings and the usual rules of procedure and evidence apply.\(^{51}\)

Claims are commenced when a claimant files a statement of claim and a notice of proceeding in the High Court.\(^{52}\) Assuming that the defendant intends to defend the claim and does not dispute the court’s jurisdiction, it will file and serve a statement of defence. Typically, the parties are then required to disclose documents to each other in a discovery process.

A key feature of litigation in New Zealand is that courts typically require unsuccessful parties to pay the successful party’s costs.\(^{53}\) These sums can be significant and act as a deterrent to bringing speculative claims.

Litigation funding, although not regulated by statute, is becoming increasingly common in New Zealand. Outside the representative context, the Supreme Court has stated that it is not prepared to take on the role of general regulator of funding arrangements.\(^{54}\) The Supreme Court concluded that a funded party should, however, disclose the following information to the court and other parties when funded proceedings commence:

\begin{itemize}
\item[a] the fact that there is a litigation funder;
\item[b] the funder’s identity and location;
\item[c] the funding agreement itself where relevant;\(^{55}\) and
\item[d] whether the funder is subject to the jurisdiction of the New Zealand courts.
\end{itemize}

More recently, the Supreme Court, and in particular the (now former) chief justice, has made remarks that could be interpreted as marking a shift towards a more supervisory role.\(^{56}\) These comments may lead to future challenges to litigation funding arrangements. However, the third-party funding of litigation in New Zealand will be considered by the Law Commission as part of its review into class actions.\(^{57}\)

**Representative actions**

The Supreme Court has imposed a relatively low threshold on the ‘same interest in the subject matter’ requirement in representative proceedings.\(^{58}\) The relevant HCR (4.24) is interpreted purposively to allow representative proceedings to be a ‘flexible tool of convenience in the

\(^{50}\) The relevant part of the HCR is Part 5.

\(^{51}\) FMCA, Section 509.

\(^{52}\) In some cases, such as derivative actions under the CA, shareholders may first need to obtain leave from the court.

\(^{53}\) HCR, Rule 14.2. Such payment of costs is on a scale rather than an indemnity basis.


\(^{55}\) If disclosure is required of the agreement it must be relevant to the particular application before the court. In this case, redaction is allowed for sensitive information (for instance, the ‘war chest’ among other matters).


\(^{58}\) Credit Suisse Private Equity LLC v. Houghton [2014] NZSC 37, [2014] 1 NZLR 541 at [2]. See also HCR, Rule 1.2, which provides that the objective of the HCR is to ensure the ‘just, speedy and inexpensive determination of any proceeding or interlocutory application’.
administration of justice’. To satisfy this ‘same interest’ requirement, it will be sufficient for the claimant party and represented parties to have ‘a community of interest in the determination of some substantial issue of law or fact’.

Representative actions have generally proceeded on an opt-in basis, with prospective members of the group needing to opt in within a set time period. However, the Court of Appeal has recently approved an opt-out approach in an insurance representative action. This means that all class members are automatically included in the proceeding, and are given the opportunity to opt-out. The Court anticipates that ‘opt-out orders will be the norm, in the absence of cogent reasons to prefer either a universal approach or an “opt in” approach by reference to the twin goals of fairness and efficiency’. This decision has been appealed to the Supreme Court but has not yet been heard by that Court. Further detail in relation to this decision is set out in the Year in Review section.

Even in instances in which all represented persons consent, the High Court has noted that it is prudent for those bringing the representative proceeding to apply for directions confirming that they may act as representative plaintiffs. Where not all persons to be represented consent to the proceeding, an application to the court for a representation order is necessary. Members of a represented group will be bound by any judgment to the extent of common issues, and may face obligations with respect to discovery of documents, answering interrogatories or payment of adverse costs awards.

A key question arising out of the Court of Appeal’s decision to allow class actions on an opt-out basis is whether the courts will be willing to make common fund orders, requiring all members of a class to contribute to the funding of a class action out of the proceeds of the judgment. At the time of writing, no New Zealand court has made a common fund order. However, an application for a common fund order is, at the time of writing, currently before the High Court in the Ross v. Southern Response Earthquake Services Limited litigation, so clarity should be provided soon. The Court of Appeal did not comment on this point, but noted it was confident that the Court had the ‘necessary tools to address any real unfairness in this context, whether under the High Court Rules or in the exercise of its inherent powers’.

The procedure for representative actions, subject to the above, follows typical civil procedural rules.

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64 Southern Response Earthquake Services Ltd v. Ross [2019] NZSC 140 (leave decision).
### Derivative actions

The court has discretion to grant an applicant shareholder leave to bring derivative proceedings. The court will have regard to the likelihood of success in the proceeding, the costs of the proceeding as against the likely relief, and any actions already taken with respect to the breaches. Notice of an application for leave must be served on the company, and the company must inform the court as to whether it intends to progress the proceedings. The procedure for derivative actions under the CA is governed by Part 18 of the HCR and largely follows civil procedural rules.

### iii Settlements

While there is no express requirement for judicial oversight of an agreement to settle civil securities actions in New Zealand, recent comments by the Court of Appeal in *Ross v. SRES* suggests such oversight will be appropriate particularly if a litigation funder is involved in the action. A settlement agreement is a contract that provides for the terms of the settlement, typically being a release of all claims by the plaintiff along with a payment from the defendant or defendants to the plaintiff. The parties generally agree regarding the apportionment of legal costs.

There are no specific rules governing the settlement of representative actions in New Zealand. Therefore it remains open to parties to reach out-of-court settlements. However, and notably, the Court of Appeal in *Ross v. SRES* recently commented that as part of its supervision of litigation funders to ensure there is no abuse of process, the court will ensure that any proposed settlement does not involve unfairness to some subset of class members.

To achieve that objective, the Court of Appeal in *Ross v. SRES* amended the representation order made by the High Court to make it clear that the plaintiffs could only discontinue the proceeding with leave of the Court. By requiring leave of the Court, the Court ensured it had an opportunity to review any proposed settlement. The decision has been appealed to the Supreme Court and but has not yet been heard by that Court.

The terms of reference published by the New Zealand Law Commission for its review of class actions and litigation funding include reference to ‘damages, costs, and settlement’. Therefore, the NZLC will presumably consider the Court of Appeal’s comments in *Ross v. SRES* (especially if the judgment, and amended representation order, is upheld by the Supreme Court).

Shareholder derivative proceedings brought with leave of the court cannot be settled, compromised or discontinued without approval of the court.  

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69 CA, Section 165(2).
72 At [104] and [138].
73 *Southern Respond Earthquake Services Ltd v. Ross* [2019] NZSC 140 (leave decision).
74 CA, Section 168.
iv Damages and remedies

The primary remedy for private actions under the FMCA is compensation. A court may make any order that it considers just in order to compensate any person who has suffered, or is likely to suffer, loss or damage. It seems likely that a New Zealand court would calculate loss in the case of defective disclosure as the difference between the purchase price and a measure of ‘market’ or other value. The exact methodology is yet to be tested.

In addition to compensatory orders, the FMCA grants the New Zealand courts the power to make a wide range of civil liability orders under Section 498, including the power to require refunds of money, vary or cancel agreements and restrain the issue or transfer of financial products.

III PUBLIC ENFORCEMENT

i Forms of action

The FMA has a broad range of criminal, civil and administrative enforcement tools. The FMA can collect and disseminate information or research about financial markets, has the power to issue warnings, reports and guidelines and make comment about any matter relating to financial markets, and it can set frameworks and methodologies for market participants.

The FMA can also issue (on an urgent basis, if necessary) orders or notices as follows:

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75 FMCA, Section 494.
76 FMCA, Sections 494–495.
77 Houghton (HC – substantive), note 8, at [699]–[712]; Houghton (SC), note 8, at [134]–[136].
78 But is likely to be the subject of substantial consideration during the stage 2 hearing in the Houghton v. Saunders proceedings.
80 FMAA, Sections 8–9; FMCA, Sections 567–569; FMA Regulatory Response Guidelines (August 2016) (available at https://fma.govt.nz/assets/Policies/160824-Regulatory-response-guidelines-policy.pdf). See also, for example, the FMA’s report on its investigation of disclosure breaches by the failed Wynyard Group Ltd (available at https://www.fma.govt.nz/assets/Investigations/Investigation-of-potential-disclosure-breaches-Wynyard.pdf), and public warning regarding Brian Ferguson, a registered financial adviser (available at https://www.fma.govt.nz/news-and-resources/warnings-and-alerts/brian-john-ferguson-fsp155185/). The FMA also has powers of designation (including the call-in of financial products) and exemption.

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a stop orders: these may prohibit offers, issues, sales or other acquisitions or disposals of financial products; prohibit an offeror from accepting applications for financial products; or prevent the distribution of disclosure documentation. The FMA can also issue, without notice, an interim stop order pending an exercise of its powers.

b direction orders: these may direct a person to comply with the law; take steps to comply with the law or to avoid any potential or actual adverse effects of a contravention; or require a person to report to the FMA regarding implementation. A direction order can also specify that a person may not rely on an exemption in the FMCA, prohibit the use of simplified disclosure and prohibit an offer under a recognition regime; and

c infringement notices: these may be issued in a limited range of circumstances and provide the FMA with a flexible means for dealing with minor offences (such as a failure to send certain notices to security holders).

The next level of intervention is the FMCA’s civil liability regime, under which the FMA can apply to the High Court for a declaration of contravention, a pecuniary penalty order, a compensatory order or other civil liability order (as described above).

The FMA can prosecute any proceeding under the FMCA and can:

a exercise and control a right of action on behalf of private litigants; and

b with leave of the High Court, represent a class of persons if the persons have the same or substantially the same interest in relation to the proceedings.

The FMA can accept enforceable undertakings (a form of negotiated settlement, which can include the payment of compensation), state a case for the opinion of the High Court and settle a case or investigation. The FMA (or any other entitled person) may also seek banning orders in the High Court. On application of the FMA (or any other person), the court may grant injunctive relief. In certain cases, the FMA may refer conduct to the Serious Fraud Office, the Commerce Commission, the Police or the Reserve Bank of New Zealand (RBNZ). At the highest level of intervention, a contravention of the FMCA coupled with knowledge or recklessness can lead to criminal prosecution by the FMA.

81 FMCA, Sections 462–467.
82 FMCA, Section 465.
83 FMCA, Sections 468–469.
84 FMCA, Sections 470–471.
85 FMCA, Sections 513–516.
86 FMCA, Section 484.
87 FMAA, Section 34. This would include, for example, the right to step in and bring claims for breaches of directors’ duties. See, for example, Prince & Partners, note 79, which was the first case where the High Court was required to examine a case instituted under Section 34 and discussion in Financial Markets Authority v. ANZ Bank Limited [2018] NZCA 590.
88 FMAA, Section 39.
89 FMAA, Sections 44–48.
90 Such orders prohibit a person from either providing financial advice or broking services or being a director or a promoter of an entity. Breaching a banning order is an offence. See Sections 517–521 of the FMCA.
91 FMCA, Section 517. The FMA may also impose conditions on, or revoke, licences.
92 FMCA, Section 480.
The FMA has a policy of publicising enforcement action unless there are policy, legal or other compelling reasons not to do so.95 This is to maximise the ‘visible deterrence’ and to educate market participants.96

ii Procedure

Search powers
One of the key differences between public enforcement and private enforcement is the information gathering powers of the FMA. If the FMA considers it necessary or desirable it may (by written notice) require a person to supply the FMA with information, produce documents, reproduce information, appear before the FMA and give evidence.97

The FMA may authorise a specified person to enter and search a place, vehicle, or other thing.98 The search may only occur if the occupier or person in charge consents or a warrant is obtained.99

Civil proceedings
The standard of proof for civil proceedings is the balance of probabilities, and the usual rules of evidence and procedure apply.100 In FMA v. Warminger, a market manipulation case brought under the old regime (the SA), the High Court required ‘strong evidence’ to be satisfied that the elements of the statutory provisions were made out on the balance of probabilities.101 It seems likely this approach will be carried over to civil proceedings under the FMCA.

The FMA has committed to act as a model litigant in civil proceedings. This leads to a number of (self-imposed) obligations, including acting honestly and fairly, but does not prevent the FMA from acting promptly, decisively and properly to protect its interests.102

Criminal proceedings
The FMA will only take criminal action where there is evidence of intentional, reckless or other serious unlawful conduct.103 Rules governing the FMA’s conduct of criminal litigation are also set out in the Solicitor-General’s Prosecution Guidelines.104

95 FMA Enforcement Policy (available at: https://www.fma.govt.nz/about-us/what-we-do/how-we-regulate/enforcement-policy/#).
97 FMAA, Section 25.
98 FMAA, Section 29.
99 FMAA, Section 29(3). When the FMA issues an infringement notice, Section 515 of the FMCA sets out the procedural requirements for doing so.
100 FMCA, Section 509.
101 FMA v. Warminger [2017] NZHC 327 [Warminger (No 1)] at [33].
102 FMA Model Litigant Policy (available at https://fma.govt.nz/assets/Policies/model-litigant-policy.pdf). The FMA must act honestly and with complete propriety, fairly and in accordance with the highest professional standards. More specifically, this includes responsibly spending public funds in relation to litigation, considering proposals of alternative dispute resolution and not pursuing appeals unless the FMA considers it has a reasonable prospect of success and, or the appeal is otherwise justified in the public interest.
The standard of proof for criminal proceedings is beyond reasonable doubt, and procedure is governed by the Criminal Procedure Act 2011.

**Declarations of contravention**

Any person, including the FMA, can apply to the court for a declaration of contravention.\(^\text{105}\) The purpose of a declaration of contravention is to lay the groundwork for a later applicant seeking a civil remedy, who can rely on the declaration of contravention as establishing the defendant’s contravention of the FMCA.\(^\text{106}\)

**Collaboration with other regulators**

The FMA has entered into memoranda of understanding with other regulators and agencies.\(^\text{107}\) One relevant example is the memorandum of understanding between the FMA and the Commerce Commission. For matters relating to misleading and deceptive conduct, the FMA has primary regulatory responsibility in relation to financial products and financial services, with the Commerce Commission taking primary regulatory responsibility for other misleading and deceptive conduct.\(^\text{108}\)

### iii Settlemnts

The FMA can settle matters either prior to, or following the commencement of, proceedings. The FMA will, pursuant to its model litigant policy, consider proposals to avoid or resolve litigation, including by cooperation or other agreed resolution.\(^\text{109}\)

When the FMA exercises a person’s right of action and brings proceedings, those proceedings cannot be settled, compromised or discontinued without the court’s approval.\(^\text{110}\) The High Court recently issued the first such approval.\(^\text{111}\) The Court assessed the settlement in light of the FMA’s objective and functions,\(^\text{112}\) and approved the settlement on the basis of the following reasons:

- \(a\) the defendant’s admissions;
- \(b\) the settlement sum was accepted as being in a ‘range commensurate’ to the losses caused; and
- \(c\) the settlement agreement was to be made public, including by way of public announcement.\(^\text{113}\)

In criminal prosecutions, the parties can find a mutually beneficial compromise, which results in the defendant facing fewer charges or pleading guilty to certain charges, or both.

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\(^{105}\) FMCA, Section 486.

\(^{106}\) FMCA, Section 487(1).


\(^{108}\) In particular in relation to consumer credit contracts.


\(^{110}\) FMAA, Section 41.

\(^{111}\) Prince & Partners, note 79.

\(^{112}\) Prince & Partners, note 79, at [8]–[12].

\(^{113}\) Prince & Partners, note 79, at [13]–[19].
iv  Sentencing and liability

Criminal proceedings
The maximum sanctions for criminal offending under the FMCA are: for individuals, up to 10 years’ imprisonment or a fine not exceeding NZ$1 million, or both; and for corporations, a fine not exceeding NZ$5 million.114

Pecuniary penalties in civil proceedings
Significant pecuniary penalties can be imposed under the FMCA. The maximum penalty applicable (e.g., for defective disclosure in regulated offers) is the greatest of:

a  the consideration for the relevant transaction;

b  three times the amount of the gain made or loss avoided by the contravention; and

c  NZ$1 million for an individual or NZ$5 million in any other case.115

A person cannot be liable for more than one pecuniary penalty for the same conduct and cannot be ordered to pay a pecuniary penalty and a fine for the same conduct.116

In determining the appropriate pecuniary penalty, the court must have reference to a variety of relevant matters, including those listed in Section 492 of the FMCA. In Warminger,117 the High Court adopted an approach to determining the appropriate pecuniary penalty that required the court to fix a starting point having regard to the relevant statutory criteria and then make deductions for personal circumstances. A similar approach is likely to be adopted under the FMCA.

Infringement notices
The maximum amount payable under an infringement notice ranges from NZ$5,000 to NZ$20,000.118 However, if an infringement offence is proceeded with summarily, the maximum fine is NZ$50,000.

IV  CROSS-BORDER ISSUES

i  Jurisdictional issues
Whether a New Zealand court will have jurisdiction over a foreign person or entity will turn on the regime for service out of jurisdiction in the HCR.120 An originating document may be served out of New Zealand without leave of the High Court in a number of situations, including, relevantly, when the claim arises under an enactment and the enactment applies expressly or by implication to an act or omission that was done or occurred outside New Zealand in the circumstances alleged.121

114  FMCA, Section 510(3). Lesser sanctions apply for certain criminal offences under the FMCA.
115  FMCA, Section 490.
117  FMA v. Warminger [2017] NZHC 1471 [Warminger (No. 2)] at [13].
118  Infringement notices can be issued for infringement of approximately 30 FMCA provisions.
120  HCR, Rules 6.27–6.36.
If jurisdiction is challenged by the defendant, then the party effecting service is required to establish that there is a good arguable case that the claim falls within one of the specified grounds and that the court should assume jurisdiction by reference to the following factors:

- there is a serious issue to be tried on the merits;
- New Zealand is the appropriate forum for the trial; and
- any other relevant circumstances support an assumption of jurisdiction.

The New Zealand courts will continue to be guided by earlier authorities relating to *forum non conveniens.*

### ii Extraterritorial application of the FMCA

#### Certain provisions of the FMCA have extraterritorial effect:

- the fair dealing provisions apply to conduct in New Zealand and to conduct outside New Zealand by any person resident, incorporated, registered or carrying on business in New Zealand to the extent that that conduct relates to dealing in financial products, or the supply of a financial service, that occurs (in part or otherwise) within New Zealand;
- the disclosure obligations in Part 3 apply to offers of financial products in New Zealand, regardless of where the resulting issue or transfer occurs or where the issuer is resident, incorporated or carries on business; and
- the provisions regarding dealing in financial products on markets in Part 5, including insider trading and market manipulation, apply to conduct in relation to quoted financial products or listed issuers regardless of whether the conduct is in New Zealand or outside New Zealand.

### iii Mutual recognition scheme

The trans-Tasman mutual recognition scheme allows issuers of securities to offer specified financial products in New Zealand and Australia, using one disclosure document prepared under the fundraising laws in the issuer’s home country.

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122 For example, the claim arises under an enactment and the relevant acts or omissions occurred in New Zealand.
125 FMCA, Section 33(1). The fair dealing provisions also apply to a restricted communication that is distributed or to be distributed to a person outside New Zealand by any person resident, incorporated, registered, or having a principal place of business in New Zealand (Section 33(2)).
126 FMCA, Section 47.
127 FMCA, Section 239.
128 *FMA, Regulatory Guide 190: Offering financial products in New Zealand and Australia under mutual recognition December 2016* at 4; Subpart 6 of Part 9 of the FMCA sets out the legislative scheme relevant to Australian issuers in New Zealand, while Chapter 8 of the Corporations Act 2001 (Aust) (and associated Regulations), sets out the same for New Zealand issuers.
**V YEAR IN REVIEW**

In October 2019, the FMA released its Annual Report for 2018–2019. The FMA described 2019 as a ‘watershed year’, with the FMCA fully implemented, conduct regulation the new norm and the FMA applying a wider lens to review conduct across the financial sector. The FMA noted the following highlights of 2019:

- completing a joint review with the Reserve Bank of New Zealand of conduct and culture within retail banks and life insurers;
- continuing its enforcement action; and
- guiding and engaging with the financial adviser industry in preparation for the FMA’s licensing and monitoring obligations under the new financial advice regime.

**i Guidance and reports**

In 2019, the FMA and RBNZ completed their joint reviews of the conduct and culture of the retail banking and life insurance industries respectively. The reviews took place in the context of the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, which had identified failings in the treatment of customers of Australian financial institutions.

The FMA/RBNZ review of retail banks identified weaknesses in the governance and management of conduct risks, and required each of the 11 banks reviewed to develop bespoke plans to address individual feedback provided to them by the regulators.

The FMA/RBNZ review of life insurance identified ‘extensive weaknesses’ in the systems and controls of the 16 life insurers reviewed, as well as instances of conduct potentially in breach of the law.

These reviews have led to regulatory reform, which is discussed further in the Legislation and Regulation section below.

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132 Indeed, the FMA far exceeded its litigation budget in 2018/2019, but funded the overspend from its reserves. The FMA successfully obtained an increase to its litigation fund for the 2019/2020 financial year onwards, with the New Zealand government announcing, on 29 October 2019, an increase to the FMA’s budget of NZ$4 million, taking its litigation fund annual budget to $6 million: See https://www.fma.govt.nz/news-and-resources/releases-from-the-minister-of-commerce/4-million-increase-in-font litigation-fund-to-strengthen-enforcement-capability/.
ii FMA enforcement action

Insider trading

The FMA filed charges against a former VMob Ltd (now Plexure Group) executive in October 2017 relating to insider trading and failing to disclose relevant interests under the SMA.\(^{136}\) On 13 March 2019, the executive pleaded guilty to a charge of failing to disclose a relevant interest under Section 19T of the SMA and provided an enforceable undertaking to the FMA not to be involved in the management of a public issuer for a period of five years and to pay the FMA NZ$150,000, all in exchange for the FMA withdrawing its insider trading charge. In April 2019, the High Court convicted the executive on the remaining non-disclosure charge and ordered him to pay a fine of NZ$12,000.\(^{137}\)

Further criminal prosecutions

Following a mistrial in May 2017,\(^{138}\) the FMA pursued its prosecution against three former directors of the Viaduct and Mutual finance companies in a retrial that commenced in August 2018. The revised charges in the retrial included theft by a person in a special relationship,\(^{139}\) making false statements as a promoter\(^{140}\) and making false statements to a trustee.\(^{141}\) All three directors were found guilty of multiple charges in verdicts delivered on 5 February 2019. On 27 March 2019, one director was sentenced to a term of three years and two months imprisonment, while the other two directors received sentences of home detention. In August 2019, the Court of Appeal set aside convictions against the director imprisoned on two charges (but upheld the other four charges) and reduced his term to 11 months home detention, taking into account the two trials and the time he had already spent in custody. One of the other directors was acquitted and the final director’s appeal against conviction was dismissed.\(^{142}\) In a separate sentence appeal, the final director had his home detention reduced to 10 months.\(^{143}\)

The FMA also obtained convictions for Crimes Act charges brought against two men in the Tauranga District Court for defrauding two elderly women of NZ$645,000, who believed they were investing in a software company.\(^{144}\) Both were sentenced to four years and six months in prison.

The FMA also charged a director and his company with offences under the Crimes Act (obtaining by deception and dishonesty using a document) for contacting people and convincing them to invest by transferring money into bank accounts he controlled and later, after incorporating a company, further cold-calling other people to promote a foreign exchange investment service that did not exist in circumstances where neither he nor his company were authorised or licensed by the FMA. Charges were also brought under the


\(^{139}\) Crimes Act 1961, Section 220.

\(^{140}\) Crimes Act 1961, Section 242.

\(^{141}\) Companies Act 1993, Section 377(2).


\(^{144}\) See https://www.fma.govt.nz/news-and-resources/cases/south-and-provan/.
FMAA for obstructing the FMA’s powers during the investigation by giving false evidence. A hearing was scheduled for 12 June 2019, but at the time of writing no judgment has been issued.\footnote{145 See https://www.fma.govt.nz/news-and-resources/cases/rodney-mccall/.

146 The alleged breaches include failure to disclose related party transactions, and false and or misleading statements in respect of solvency ratios and the use of IPO proceeds.

147 See https://www.fma.govt.nz/news-and-resources/cases/cbl/.


151 \textit{Ross v. Southern Response Earthquake Services Limited} [2019] NZCA 431 (Ross (CA)).}

\section*{CBL Corporation Limited}

In December 2019, the FMA commenced two sets of civil proceedings against CBL Corporation Limited (CBL), its directors and chief financial officer, alleging multiple breaches of the FMCA. The first proceeding alleges breaches of the FMCA in the context of CBL’s Initial Public Offering (IPO).\footnote{146 The second proceeding alleges (1) failure to comply with CBL’s continuous disclosure requirements and (2) misleading and deceptive conduct and or unsubstantiated representations regarding a market announcement in 2017.\footnote{147 See https://www.fma.govt.nz/news-and-resources/cases/rodney-mccall/.

146 The alleged breaches include failure to disclose related party transactions, and false and or misleading statements in respect of solvency ratios and the use of IPO proceeds.

147 See https://www.fma.govt.nz/news-and-resources/cases/cbl/.


151 \textit{Ross v. Southern Response Earthquake Services Limited} [2019] NZCA 431 (Ross (CA)).} The second proceeding alleges (1) failure to comply with CBL’s continuous disclosure requirements and (2) misleading and deceptive conduct and or unsubstantiated representations regarding a market announcement in 2017.\footnote{147 See https://www.fma.govt.nz/news-and-resources/cases/rodney-mccall/.

146 The alleged breaches include failure to disclose related party transactions, and false and or misleading statements in respect of solvency ratios and the use of IPO proceeds.

147 See https://www.fma.govt.nz/news-and-resources/cases/cbl/.


151 \textit{Ross v. Southern Response Earthquake Services Limited} [2019] NZCA 431 (Ross (CA)).}

In addition, in October 2019 two litigation-funded class actions were announced against CBL and its directors seeking compensation for investors as a result of alleged defective disclosures.\footnote{148 At the time of writing, the FMA’s proceedings and the two class actions against CBL are ongoing.\footnote{149 See CBL Investigation Update (available at https://www.fma.govt.nz/news-and-resources/media-releases/cbl-investigation-update-2/).


151 \textit{Ross v. Southern Response Earthquake Services Limited} [2019] NZCA 431 (Ross (CA)).} At the time of writing, the FMA’s proceedings and the two class actions against CBL are ongoing.\footnote{149 See CBL Investigation Update (available at https://www.fma.govt.nz/news-and-resources/media-releases/cbl-investigation-update-2/).


151 \textit{Ross v. Southern Response Earthquake Services Limited} [2019] NZCA 431 (Ross (CA)).}

\section*{iii Ross Asset Management class action}

In July 2019, a litigation-funded class action on behalf of eligible investors in a failed asset management company, Ross Asset Management (RAM), was filed against a major retail bank in relation to its role as banker. David Ross, the former director of RAM, was jailed in 2013 after pleading guilty to fraud that left investors NZ$115m out of pocket when RAM collapsed in 2012. In bringing the class action, the authors understand that the claimants relied on information shared by the FMA, which in turn had compelled that information from the relevant bank under its statutory information gathering powers. In March 2020 the High Court heard an application to strike out the claim against the bank, and judgment is awaited.

The FMA has confirmed that, since RAM investors are pursuing their private claims against the bank by way of class action, there was no need for the FMA to determine whether to use its statutory powers to pursue an action on their behalf.\footnote{150 See https://www.fma.govt.nz/news-and-resources/media-releases/fma-comments-on-ross-asset-management-investor-proceedings/.

151 \textit{Ross v. Southern Response Earthquake Services Limited} [2019] NZCA 431 (Ross (CA)).}

\section*{iv Ross v. Southern Response Earthquake Services Limited}

In September 2019, the Court of Appeal released its landmark decision in \textit{Ross v. SRES}, which has confirmed the availability of representative actions that proceed on an opt-out basis, as outlined in Section II.\footnote{151 Prior to \textit{Ross v. SRES}, representative actions generally proceeded on an opt-in basis.

In *Ross v. SRES* the Court of Appeal confirmed that there was no jurisdictional barrier to making an opt-out order under Rule 4.24. The opt-out order made in that case, however, applied only in respect of stage one of the trial (which would determine the representative plaintiff’s claim in its entirety and the common issues in respect of the entire class). For the second stage trial (which would determine the remainder of the claim), claimants would have to take active steps to establish their individual claims (i.e., opt in and provide all relevant evidence). The Court considered that opt-out orders are likely to significantly enhance access to justice and strengthen incentives for insurers and other large entities dealing with the public to comply with the law.

In December 2019, the Supreme Court granted leave to hear an appeal. If the Supreme Court agrees with the Court of Appeal that opt-out orders may be made in representative proceedings, a new era of representative actions is likely to occur in New Zealand, with significant implications for securities litigation. It remains to be seen whether the New Zealand Law Commission will recommend the same approach approved by the Court of Appeal in *Ross v. SRES* (especially if it is upheld by the Supreme Court) during its review of class actions and litigation funding in New Zealand.

### VI OUTLOOK AND CONCLUSIONS

Securities litigation and regulatory enforcement continues to be a significant risk facing market participants.

The FMA aims to take an ‘intelligence-led and harm-based’ approach to regulation, analysing the information it receives as a means of identifying and assessing the areas of greatest harm to investors, customers, and financial markets, and the drivers of that harm. Market participants who fail to comply with their obligations will receive a response proportionate to the level of harm identified by the FMA. Conduct and culture across a number of industries remained a key focus of the FMA in 2019; in particular, its joint review of conduct and culture within retail banks and life insurers, which was the ‘single largest thematic review’ the FMA has undertaken.

**i Pending cases**

In April 2019, the FMA filed 15 causes of action against four current and former executives of Oceania Natural Limited (ONL) for alleged breaches of the market manipulation prohibitions and disclosure obligations in the FMCA. This followed a referral by the NZX in December 2016 regarding trading in ONL shares. This case is currently before the courts.

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152 *Ross* (CA), note 151 at [81], [83] and [111].
153 *Ross* (CA), note 151 at [35].
154 *Ross* (CA), note 151 at [98] and [99].
155 *Southern Response Earthquake Services Ltd v. Ross* [2019] NZSC 140.
159 See https://www.fma.govt.nz/news-and-resources/cases/onl/.
### Legislation and regulation

The Financial Services Legislation Amendment Act 2019 (FSLAA) received royal assent, passing it into law, on 8 April 2019 and introduces a new regulatory regime for financial advice that is currently scheduled to come into force on 29 June 2020. FSLAA amends a number of New Zealand Acts, including the FMCA, in particular repealing the Financial Advisers Act 2008 and bringing financial advisers under the ambit of the FMCA.\(^{160}\) The FMA sees FSLAA as an ‘opportunity for customer-centric conduct to be permanently embedded in the culture of the financial sector’, particularly in light of recent FMA reports into conflicted conduct and replacement business issues in the insurance industry.\(^{161}\) The FSLAA introduces licensing, disclosure and conduct obligations for financial service providers (a new concept based on the provision of regulated financial advice). Financial service providers currently have until 29 June 2020 to obtain a transitional licence, and a further two years to comply with the obligations introduced by FSLAA. However, as a result of the significant disruption and other impacts of the covid-19 pandemic, an intention to defer the start date of the new financial advice regime set out in the FSLAA from 29 June 2020 to early 2021 has been signalled.

The Financial Markets (Derivatives Margin and Benchmarking) Reform Amendment Act 2019 was also given royal assent on 30 August 2019. The Act also amends a number of statutes so as to enable New Zealand financial market participants to comply with international rules, and continue to enter into derivatives and other types of financial instruments with overseas financial entities. The Act introduces a new licensing regime for administrators of financial benchmarks under the FMCA, which aims to enable those benchmarks to be referenced in financial instruments with international counterparties.

Following the RBNZ and the FMA’s joint review into the conduct and culture of banks and life insurers in New Zealand,\(^{162}\) the Financial Markets (Conduct of Institutions) Amendment Bill was introduced into Parliament on 11 December 2019 in response to findings that certain institutions ‘lack focus on good customer outcomes for customers and have ineffective systems and controls to identify, manage and remedy conduct issues’.\(^{163}\) Key changes will include a new licensing regime\(^{164}\) and the introduction of a ‘fair conduct principle’ to treat consumers fairly, including by paying due regard to their interests.\(^{165}\)

As noted above in respect of FSLAA, many of the regulatory initiatives due for consultation or implementation in the near future have been deferred as a result of the evolving circumstances surrounding the covid-19 pandemic.

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\(^{160}\) Financial Services Legislation Amendment Act 2019, Schedule 2.


\(^{163}\) Financial Markets (Conduct of Institutions) Amendment Bill, explanatory note.

\(^{164}\) Financial Markets (Conduct of Institutions) Amendment Bill, Sections 6 and 8.

\(^{165}\) Financial Markets (Conduct of Institutions) Amendment Bill, Section 9.
Chapter 14

PORTUGAL

Nuno Salazar Casanova and Nair Maurício Cordas

I OVERVIEW

i Sources of law

The rules applicable to securities in Portugal derive mainly from laws and regulations enacted by the Portuguese Securities Market Commission (CMVM).

The main legal source applicable to securities in Portugal is the Securities Code, enacted by Decree-Law No. 486/99 of 13 November, as amended, which sets out the general legal framework applicable to securities, public offers, exchange markets, financial intermediation and supervision of capital markets.

The legal framework under the Securities Code is complemented by the regulations and instructions issued by the CMVM pursuant to its regulatory powers. The CMVM also issues general 'soft law' instruments, such as recommendations and general opinion assessments, which, although lacking binding regulatory effect, offer guidance to market participants for the application and interpretation of the corresponding legal provisions.

Specific legislation may apply to particular securities instruments and transactions (e.g., commercial paper, covered bonds).

Other relevant legal instruments pertaining to the Portuguese securities markets include the Commercial Companies Code, enacted by Decree-Law No. 262/86 of 2 September, as amended; the Commercial Code, enacted by Letter of Law of 28 June 1888, as amended; the Credit Institutions and Financial Companies Framework enacted by Decree-Law No. 298/92 of 31 December, as amended; and the Civil Code, enacted by Decree-Law No. 47344 of 25 November 1966, as amended.

ii Regulatory authorities

Securities enforcement actions in Portugal are generally brought by three authorities: the CMVM, the Bank of Portugal and the Public Prosecutor’s Office.

The CMVM, under the supervision of the Ministry of Finance, is empowered to regulate, monitor and supervise the conduct of financial markets, issuers of securities and financial instruments and financial intermediaries, as well as to enforce the Securities Code and related regulations. The CMVM’s statutory framework is currently set forth in Decree-Law No. 473/99 of 8 November, as amended.

In addition to the supervision of entities subject to its jurisdiction, the CMVM may issue regulations on matters covered by its duties and powers.

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1 Nuno Salazar Casanova is a partner and Nair Maurício Cordas is a senior associate at Uría Menéndez – Proença de Carvalho.
The Bank of Portugal, as Portugal’s central bank, supervises and controls the banking sector, regulating and supervising all credit institutions and investment companies acting in the country. The Bank of Portugal also enforces the Credit Institutions and Financial Companies Framework and related regulations.

Although the CMVM and the Bank of Portugal do not have the power to bring criminal charges, they nevertheless have extensive supervisory, regulatory and enforcement powers. In particular, they may initiate proceedings for administrative offences and impose penalties of up to €5 million (which can be raised up to a maximum of 10 per cent of the perpetrator’s turnover or to triple the economic benefit obtained) and severe ancillary sanctions.

The Public Prosecutor’s Office has exclusive powers to bring criminal charges, regardless of the nature of the crimes. For instance, despite the existence of the CMVM, only the Public Prosecutor’s Office can charge someone with criminal market manipulation.

In some cases, the CMVM may conduct preliminary investigations of crimes, although the investigation must ultimately be handed over to the Public Prosecutor’s Office for charges to be brought against the perpetrator. The Public Prosecutor’s Office also represents the Portuguese state in any civil claim against third parties (thus acting as ‘general attorney’).

iii Common securities claims

Since 2008, because of the financial crisis, there has been an increase in securities litigation in Portugal, particularly relating to the mis-selling of listed shares, bonds, commercial paper and interest-rate swap agreements.

Most cases brought to court by investors against financial institutions relate to civil liability concerning the sale of negotiable securities and other financial products. These claims seek compensation for damages and are generally based on mis-selling and breach of duties of information. In broad terms, investors typically claim that the financial institution did not comply with its information duties, either having provided inaccurate or insufficient information or simply having omitted the required information, whether through fault or negligence.

Further, claims seeking the annulment of sale and purchase agreements of securities have also become common in Portugal, specifically on the grounds of an investor’s error regarding the nature and risks of the securities or an abnormal change of circumstances caused by the financial crisis.

Regarding interest-rate-swap agreements, it is frequently argued that they should be classified as a game of chance and therefore prohibited under Portuguese law, and that the sharp drop in interest rates caused by the financial crisis was an abnormal change of circumstances that allows the termination of the contract.

Investors have also brought claims against issuers of securities for damages allegedly caused by misleading information concerning their financial situation, fraud and falsification of documentation. This was the case in high-profile cases such as those relating to Banco Privado Português, Banco Comercial Português and Grupo Espírito Santo. Claims were also brought against auditors and the regulatory authorities, namely the CMVM and the Bank of Portugal, for breach of their corresponding duties, although most of these claims have since been rejected by the courts.

In recent years, there have also been a growing number of claims concerning the monitoring of investments and the obligations of financial intermediaries following the client’s investment decision, in particular those concerning potential information duties.
regarding subsequent changes to the risks of the financial instruments and even advice duties during the investment period. This was the case for certain bonds issued by Portugal Telecom SGPS, S.A. and by Portugal Telecom International Finance BV.

In light of the resolution measures regarding Banco Espírito Santo (BES) and Banco Internacional do Funchal (Banif), Portugal has also been witness to a new wave of litigation directed at the Bank of Portugal, challenging said resolution measures. Although the validity of a resolution measure itself may only be challenged before the administrative courts, the civil courts have been indirectly asked to review these measures, especially as to whether it was a constitutional decision not to transfer subordinated bonds to Novo Banco. On 19 June 2019, the Portuguese Supreme Court held that the BES resolution measures did not breach the constitutional principles of trust and legal certainty, nor the principle of the separation of powers.\(^2\)

Litigation on criminal and administrative offences related to securities – but not the sale of securities – has also grown in the past few years. In these proceedings, in addition to crimes such as insider dealing and market manipulation, the main charges relate to fraud, false accounting and improper management, as well as use of false or misleading information. This has been the case in high-profile cases relating to various Portuguese banks, specifically Banco Português de Negócios, Banco Comercial Português and, most recently, BES.

In litigation related to securities, criminal liability is usually attributed to directors or representatives of the entity issuing the security, although legal entities can also be held criminally liable in Portugal for some crimes, such as misleading advertising, fraud, false accounting and schemes to manipulate market prices. In light of the recent high-profile cases, the Securities Code’s criminal framework was amended.\(^3\) For instance, the crime of market manipulation was amended to reflect new types of markets and phenomena, such as benchmarks, emission licences or spot commodity contracts. The crime of insider trading was also amended and now includes other types of criminal acts, such as the cancellation or amendment of an order, or the attempt to cancel or amend an order. In addition, the amendments to the Securities Code introduced a new type of crime that consists of using false or misleading information for the capture of investment. This is punishable with imprisonment from one to six years, or, if any investment is effectively captured, from two to eight years.

II PRIVATE ENFORCEMENT

i Forms of action

In Portugal, private enforcement securities actions are typically brought by investors for contractual or non-contractual liability or seeking the annulment of contracts.

In liability claims, investors usually claim compensation for damages, arguing that the financial institution did not comply with its information duties. In these cases, the plaintiffs must allege and prove that: (1) no information was provided or that the information provided

\(^2\) Decision of 19 June 2019, proceeding no. 4140/14.0YYLSB.L1.S1

was inaccurate or insufficient through the fault or negligence of the financial institution;\(^4\) (2) they suffered real and actual damages; and (3) the damages were caused by inaccurate or insufficient information or a lack of information.\(^5\)

In actions for annulment of contracts, investors commonly argue that there was an error regarding the nature and risks of the contract or an abnormal change of circumstances. Should the plaintiffs prevail, these actions result in the annulment of the contract and, consequently, in the mutual restitution by the parties of the corresponding consideration exchanged.

The defence in securities litigation matters is generally grounded on the adequacy of the product to the investor’s profile, the information provided during the sale, the specific documentation signed by the investor and the information made available after the contracting process.

The statement of defence of the financial institutions usually focuses on, first, proving that all the duties of information were duly complied with, and second, that the institution acted as a mere financial intermediary, without any private interest in the transaction. Financial institutions claim that the investors fully understood the transaction, were not in error regarding the nature and risks of the contract and argue that the contracts are valid pursuant to Portuguese law. Additionally, financial institutions argue that the financial crisis or the sharp fall in interest rates do not qualify as abnormal changes of circumstances. Financial institutions commonly invoke multiple objections, such as statutes of limitation of civil liability, abuse of rights and the existence of an arbitration agreement.

The Securities Code explicitly grants standing to non-qualified investors, associations for the defence of investors and foundations created for the protection of investors to bring class actions for the protection of collective or individual homogeneous interests of non-qualified investors in financial instruments. If the financial institution is found liable for damages in the class action, it must indicate the entity – a guarantee fund, an association for the defence of investors or one or more of the investors identified in the action – that will be in charge of receiving and managing the compensation due to all investors that could not be individually identified.

\(^4\) See decision of 11 July 2019 of the Portuguese Supreme Court, Proceeding No. 901/17.7T8VRL.

\(^5\) See decision of 26 March 2019 of the Coimbra Court of Appeal, Proceeding No. 3307/16.1T8LRA.C2:

\[\text{’}It \text{ having been proven, clearly, that: it was the bank that contacted the customer to convince him to subscribe subordinated bonds and informed him that the investment was 100\% capital and interest guaranteed by the Bank itself; he stated that he only agreed to such subscription if it were totally free from any risk of losing his money; he would not have agreed to invest his money in these securities had he known that it had no guaranteed capital; and the capital was lost, it must be concluded that the institution did not fulfil, with the scope and accuracy required by law, its information duty regarding the product sold, and thus acted illicitly. The other contractual liability requirements having been met, it is obliged to compensate for the losses’.\]
Civil judicial proceedings are initiated by means of a written petition. The plaintiff must argue the material facts constituting the cause of action. For example, if the claim seeks compensation on the grounds of breach of information duties, the plaintiff must allege that the financial institution did not comply with the corresponding duties, that the financial institution acted with fault or negligence, that those circumstances resulted in damages to the plaintiff, and, lastly, that there exists a causal link between the damages and the breach of information duties.

In claims pertaining to the mis-selling of securities, the decision as to who bears the burden of proof regarding the fulfilment of information duties is particularly important. In a 2017 ruling concerning an interest-rate-swap agreement, the Portuguese Supreme Court, contradicting the majority of Portuguese jurisprudence, ruled that, according to the regime on general contractual clauses, the burden of proving that the bank complied with its information duties rested with the bank itself. This understanding was further confirmed in a ruling of the same court on 26 March 2019. However, in a ruling issued on 7 November 2019, the Supreme Court once again considered that it is the claimant who must prove that the financial intermediary did not comply with its information duties.

In this context, it should also be noted that Portuguese courts have mostly held that in mis-selling claims the claimant must prove the cause–effect relationship between the breach of duties and the damages suffered. This usually amounts to proving that the claimant would not have bought the financial products if the bank had complied with its duties, which may be difficult to prove, thus leading to many claims against financial institutions being rejected. In recent years, certain decisions from the Courts of Appeal have argued that this cause–effect relationship should be presumed, and hence the burden of proving that the relationship did not exist lies with the financial intermediaries. Although such a presumption would certainly be a game changer in most mis-selling claims, the Portuguese Supreme Court has upheld and restated its previous jurisprudence, stating that there is no such presumption.

Subsequently, the defendant must present its defence, either asserting that the facts alleged by the plaintiff are not true, do not produce the consequences claimed by the plaintiff...
or that the plaintiff’s petition must be dismissed for some other circumstance, such as a legal objection. For instance, the defendant may argue that it did, in fact, provide all information required by law or that the plaintiff’s petition for compensation must be dismissed because of the statute of limitations. The defendant may file a cross-complaint, in which case the plaintiff may reply. The plaintiff and the defendants must file their requests for evidence along with the legal briefs.

In civil proceedings, parties having the burden of proof are required to disclose documents and information that support their claims or defence. Unlike the common law system, Portuguese law does not provide for a disclosure or discovery phase. Further, Portugal lodged a reservation to the Hague Convention with regard to the taking of evidence in civil and commercial matters, declaring that it will not execute letters of request issued for the purpose of obtaining pretrial discovery of documents as practised in common law countries. Notwithstanding, the parties may request that the court orders that certain documents in the possession of the counterparty or of a third party are produced to prove facts alleged in the proceedings, which the court may do if it deems them relevant to the dispute.

The pleadings phase is usually followed by a preliminary hearing in which procedural matters are discussed by the parties and decided upon by the judge. The parties may change their requests for evidence in the preliminary hearing. The judge may order specific documents to be presented by the parties or by third parties and may order expert reports to be made. The judge should also schedule the trial dates.

Witnesses and experts are examined at the trial hearing. Subsequently, the parties present their closing arguments and the court issues the final decision. In litigation involving sums exceeding €5,000, the decision may be appealed.

In addition, in recent years, arbitration proceedings related to securities litigation have increased. Portuguese arbitral proceedings tend not to differ significantly from judicial proceedings, which is to say that they usually have the same procedural phases as the former (i.e., a pleadings phase, followed by a preliminary hearing and, subsequently, by the trial hearing).

iii Settlements

Under Portuguese law, the parties may reach a settlement at any stage, provided that it does not affect inalienable rights. The claimant may also, at any time, waive its claim.

If a court settlement is reached, the agreement must be judicially approved. The court will verify whether the settlement is valid and whether the signatories have sufficient powers to execute it.

Under Portuguese law, there are no mandatory rules governing the payment of attorneys’ fees pursuant to a settlement. Judicial fees are usually borne by both parties in equal shares and each party bears its own attorneys’ fees.

iv Damages and remedies

Pursuant to the Portuguese Civil Code, whoever causes damage to another person through wilful misconduct or negligence may be subject to contractual or non-contractual liability and, consequently, be ordered to pay compensation for damages.

In securities litigation, damages usually refer to the losses suffered by the investor. For example, if the investor purchased bonds that lost their value because the issuer became
insolvent, the financial intermediary could be ordered to pay the price of the bonds. In litigation relating to an interest-rate-swap agreement, the financial institution could be ordered to pay the negative financial flows of the swap agreement.

Other common remedies sought by investors include the annulment of the contract, the termination of the contract and barring the financial institution from initiating enforcement proceedings, charging bank accounts or registering the debt in the Central Credit Register.

Civil liability may also be sought through criminal proceedings. In fact, civil liability may be acknowledged and decided by the criminal courts when deciding a criminal case.

III PUBLIC ENFORCEMENT

i Forms of action

In Portugal, there are two forms of public enforcement of securities actions: criminal proceedings and administrative offences proceedings.

Public securities actions are brought against the perpetrator by the Public Prosecutor’s Office, by the CMVM or by the Bank of Portugal. In some cases, the issuance or sale of securities may have consequences in the financial institution accounts or financial ratios, and – if there is a breach of the respective governing rules – the Bank of Portugal may also initiate enforcement proceedings. For example, if the financial institution sells bonds and guarantees payment or interest but does not register that liability in its accounts, it may be subject to administrative proceedings for having false or inaccurate accounts. Hence, although the CMVM is the regulator empowered to supervise the securities market, the Bank of Portugal may have an indirect intervention.

In Portugal, the Public Prosecutor’s Office has exclusive powers to bring criminal charges regardless of the nature of the crimes, although in some cases administrative regulators may conduct preliminary investigations of crimes (e.g., the CMVM may investigate the crime of market manipulation). Ultimately, however, the investigation must be handed over to the Public Prosecutor’s Office for charges to be brought against the alleged perpetrator.

Regulators can collaborate on the investigation and information may be shared between the enforcement agencies, with the exception of information and documents subject to privilege and information that can only be used for specific purposes (e.g., information obtained from a judicially authorised seizure for the purposes of prosecuting a crime may not be used in administrative offence proceedings).

Proceedings for administrative offences may be brought by the CMVM and the Bank of Portugal for breaches of the Portuguese Securities Code and the Credit Institutions and Financial Companies Framework, respectively, within their enforcement powers, which allow the two organisations’ regulators to impose severe penalties and ancillary sanctions.

Since the financial crisis, there has been an increase in prosecution activity by the supervisory authorities with regard to securities, and a special court for regulatory matters was set up to enhance the capacity to respond to regulatory demands.

The Public Prosecutor’s Office and the administrative regulators may – and do – simultaneously investigate the same entities for similar or identical facts. Although there is no obligation for these government entities to coordinate their investigations, all regulators must report to the Public Prosecutor’s Office if they suspect a crime has been perpetrated.

In recent cases, the Public Prosecutor’s Office and the administrative regulators have investigated and sanctioned very similar – if not identical – facts. For instance, forged accounts have concurrently been considered a crime (forgery of documentation), an offence
sanctioned by the Bank of Portugal (breach of the duty to report the true financial situation of a bank) and an offence sanctioned by the CMVM (introducing false information to the market). This situation has raised public concern on the basis of potentially breaching the *ne bis in idem* rule. However, the courts have not yet rendered decisions on this issue.

**ii Procedure**

Criminal investigations must be initiated by the Public Prosecutor’s Office when it acquires knowledge that a crime or offence has been committed, whether directly or on account of a report. The mere reporting of a crime is sufficient for the Public Prosecutor’s Office to open a criminal investigation, unless the report is anonymous, in which case an investigation may only be initiated if there is evidence of the commission of a crime.

With regard to securities-related criminal prosecution, once the investigation phase has terminated, the Public Prosecutor’s Office must decide whether to charge the alleged perpetrator or close the proceedings. If the alleged perpetrator is charged, it may then request that a judicial investigation phase be opened and conducted to ascertain whether or not it should be charged and subject to trial for the relevant crime.

If the judge renders a charging decision, the accused party must then present the corresponding statement of defence and will subsequently be subject to trial, upon the termination of which the judge will render a decision. That decision may generally be appealed to a superior court.

Administrative offence proceedings, which are brought by the relevant administrative regulator, are initiated with an investigation. If evidence of an offence is collected, the regulator issues an accusation. In recent cases, the administrative regulators have come under fire for not presenting their evidence, which is usually composed of tens of thousands of pages of documents, in a systematic, coherent and organised form, to an extent that it forgoes the defendant’s right of defence. In fact, the court with exclusive jurisdiction on competition, regulation and supervisory matters recently decided to annul the Bank of Portugal’s accusation and subsequent final decision in a high-profile case on the grounds that the defendant’s right of defence had been violated owing to the way in which the Bank of Portugal presented its evidence.\(^\text{10}\) Although the Bank of Portugal has since appealed that decision, which is currently pending, we have begun to see small changes in the way in which these proceedings are conducted. For instance, in other proceedings, the Bank of Portugal has provided defendants with a list of the documents included in the proceedings.

After being served the accusation, the defendant must then file the corresponding defence and its request for evidence. The regulator will produce all the evidence it deems relevant. Afterwards, the regulator will render its final decision. If not acquitted, the defendant may appeal to a court with exclusive jurisdiction on competition, regulation and supervisory matters.

In recent years, there has been outrage in Portuguese public opinion at cases in which bankers have been acquitted on the grounds of the statutes of limitation. The perception that bankers were always left unpunished is putting pressure on the administrative regulators and courts to render convictions.

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\(^{10}\) Notwithstanding having provided the defendants with a DVD containing tens of thousands of documents, the Bank of Portugal had simply indicated that the relevant evidence was all documents included in the proceedings, without identifying what those documents might be or making reference to the same in the facts alleged in the accusation.
However, the pressure of public opinion has raised fears regarding the impartiality of the decisions and the full respect of defendants’ rights. This has been especially the case in the recent high-profile cases relating to Banco Privado Português, Banco Comercial Português and Grupo Espírito Santo, regarding which the administrative regulators have also been accused (mostly by investors) of breaching their corresponding duties. Those cases have particularly raised concern among lawyers and scholars on the impartiality of the administrative regulators, considering that, during the administrative phase of the proceedings, the administrative regulators have the exclusive power to investigate, accuse, produce the evidence they deem fit and render a final decision, which can lead to the enforcement of millions of euros in penalties.

### Settlements

Under Portuguese law, it is not possible to settle securities claims within criminal and administrative offence proceedings. Currently, only the Portuguese Competition Law allows a settlement with a guilty plea as an alternative to prosecution.

Nevertheless, the Bank of Portugal and the CMVM may agree to issue an opinion on the sanction likely to be applicable in the event of a guilty plea and the full cooperation of the perpetrators, thus allowing the latter to weigh their options.

In addition, the Securities Code was recently amended, establishing a new regime for a reduction of the penalty based on a system of confession and collaboration of the defendant. The maximum and minimum limits of the applicable penalties and ancillary sanctions may be reduced by one-third if the defendant (1) confesses to the facts; (2) provides relevant information to reveal the truth of facts; or (3) effectively assists in the production of evidence that is decisive for establishing the facts or for identifying other perpetrators. The maximum and minimum limits of the applicable penalties and ancillary sanctions may be reduced to half if the defendant simultaneously confesses to the facts and collaborates with the authorities in revealing the truth of the facts and identifying other perpetrators.

The Portuguese Criminal Procedure Code also establishes that the Public Prosecutor may – subject to the judge’s authorisation – stay the proceedings for crimes punishable with a maximum five years’ imprisonment for a certain period as long as the defendants comply with specific injunctions. If the injunctions are satisfied and the defendant does not commit a similar crime during the period of stay, the proceedings are definitively closed. This possibility has rarely, if ever, been used in securities enforcement actions.

### Sentencing and liability

In securities-related criminal proceedings, the perpetrators are subject to imprisonment or to the payment of fines. Factors that help determine the applicable penalty include the severity of the infraction and its consequences, the intensity of the perpetrators’ fault or negligence, the personal and economic conditions of the perpetrators, and recidivism.

In administrative offence proceedings, the CMVM may impose severe fines and ancillary sanctions. The catalogue of penalties for administrative offences subject to the Securities Code was amended in 2018, with a notable increase in the amounts of penalties. For instance, penalties applicable to less serious misconduct have doubled from a minimum of €2,000 to €5,000 and a maximum of €500,000 to €1 million. The amount of the applicable fine depends on the severity of the infraction, subject to a maximum of €5 million. However, this amount can be increased up to a maximum of 10 per cent of the perpetrator’s turnover, with the exception of offences resulting from market manipulation and the use or transmission of
inside information, which are punishable by a fine up to 15 per cent of the turnover of the infringing entity. In any case, the penalty may be increased up to triple the economic gain of the perpetrator.

Ancillary sanctions may also be applied for crimes or administrative offences, the most relevant of which include publication of the decision at the expense of the perpetrator, loss of economic proceeds from the offence, temporary suspension or definitive prohibition against carrying out the activity underlying the offence, prohibition from entering into specific contracts or entering into contracts with specific entities, exclusion from public subsidies and aid, and closure of the commercial establishment. The catalogue of ancillary penalties has also been amended to include the prohibition of trading on one’s own account, and the cancellation of registrations or the revocation of authorisations for the exercise of management, directorship or supervisory functions in entities subject to the supervision of the CMVM.

The determination of the fine and ancillary sanctions depends on the material illegality of the act, the agent’s negligence, the benefits obtained and the prevention requirements. The following circumstances, among others, are taken into consideration when determining the material illegality of the act and the negligence of legal and similar entities: (1) the danger or damage caused to investors or the market for securities or other financial instruments; (2) the sporadic or repeated nature of the offence; (3) any concealment of acts tending to impair discovery of the offence; and (4) the existence of acts by the agent, at the agent’s own initiative, aiming at curing the damages or mitigating the dangers caused by the offence. The following circumstances are taken into consideration when determining the material illegality of the act and negligence of natural persons, beside those relevant to legal entities: (1) the level of responsibility, scope of functions and role in the legal entity; (2) the intention to obtain, for itself or another entity, an illegitimate benefit or damages caused; and (3) the special duty to not commit the offence. In the determination of the applicable sanction, the agent’s economic situation and previous and subsequent conduct are also taken into consideration, such as his or her collaboration with the CMVM or the court.

Lastly, the Securities Code was also amended to specify that the administrative liability of a legal person is only excluded when its agent acts against precise and specific orders or instructions, which were transmitted to the agent in writing before the commission of the infraction.

IV CROSS-BORDER ISSUES

As a general rule, Portuguese entities only have jurisdiction with regard to securities-related matters that occurred in Portugal. Thus, in principle, private or public enforcement proceedings will only be brought against entities exercising their activities in Portugal and with regard to criminal or administrative offences perpetrated in Portugal.

Notwithstanding the above, the Portuguese Securities Code establishes rules that require mandatory application, namely those that are applicable to cross-border situations that would otherwise be subject to foreign legislation pursuant to the general Portuguese conflict-of-law rules. These rules are applicable to cross-border situations to the extent that a material connection can be established between the specific circumstances and the Portuguese jurisdiction.

For this purpose, a material connection to Portuguese territory is considered to exist when: (1) orders are addressed to members of regulated markets or multilateral negotiation
systems registered with the CMVM, and operations are carried out in those markets; (2) activities are carried out, and acts are performed in Portugal; or (3) the diffusion of information that is made accessible in Portugal makes reference to situations, activities or acts regulated by Portuguese law.

On the other hand, pursuant to EU Regulation No. 1215/2012 (Brussels I bis) Portuguese courts have jurisdiction in civil and commercial matters when the contractual parties have agreed to submit their disputes to Portuguese courts or when the respondent, irrespective of nationality, is domiciled in Portugal.

A defendant domiciled in another EU Member State may be sued in Portugal in the following cases: (1) when the contract in which the claim is based was performed in Portugal; (2) in tortious matters when the harmful event occurred in Portugal; (3) when civil liability stems from criminal proceedings held in Portugal; and (4) under certain circumstances where there is more than one respondent and one is domiciled in Portugal.

Notwithstanding the above, defendants not domiciled in an EU Member State may be sued before Portuguese courts in two circumstances relevant to securities litigation: (1) when the dispute is connected to the operations of a branch, agency or other establishment situated in Portugal; and (2) when disputes arise out of contracts with consumers that are domiciled in Portugal, provided that the other party pursues commercial or professional activities in Portugal.

V YEAR IN REVIEW

As a result of the financial crisis of the past decade, securities-related litigation in Portugal has been consistent in its frequency, with interest-rate-swap agreements, Banco Privado Português, Banco Português de Negócios, Espírito Santo/Banco Espírito Santo (GES/BES) groups, Portugal Telecom and Banif appearing in the limelight.

The resolution measure applied to BES in 2014 continued to be a fruitful source of securities-related litigation in the past year, with several civil liability proceedings still pending.

Pursuant to the memorandum of understanding entered into between an association created for the protection of bond and commercial-paper investors and the Portuguese government, the CMVM, the Bank of Portugal and BES, a fund by means of which the investors shall be partially compensated was established. Said fund is not only substituting the private investors in the pending judicial proceedings, but also filing new judicial proceedings against investment banks and directors.

Institutional investors have also brought claims against the regulatory authorities, namely the Bank of Portugal, with a view to challenging both the original resolution measure and the December 2015 retransfer decision (as it may be considered to affect the equal treatment of creditors within their respective rankings). In March 2019, one of several claims challenging the resolution measures was rejected by the first-instance administrative court. The case is currently under appeal.

Furthermore, litigation pertaining to Banif’s resolution measure, both challenging said resolution measure and looking to hold Banco Santander Totta liable for the mis-selling of bonds on the grounds that investors were misled regarding the nature and risks of the securities, has carried on and is expected to continue.

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11 In late 2015, the Portuguese government and the Bank of Portugal decided to sell Banif’s business and most of its assets and liabilities to Banco Santander Totta. The sale was carried out in the context of a

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There has also been a significant increase in litigation regarding bonds issued by Portugal Telecom SGPS, S.A. (the holding company of the PT Group) and PTIF, the company that issued most of the PT Group bonds (guaranteed by the holding company). In 2015, a corporate event occurred: PT Group was sold to Oi, S.A. and Portugal Telecom SGPS, S.A. became a minority shareholder of Oi, and thus was no longer the issuer or guarantor of the bonds. However, due to this corporate event, the clients had the possibility of early redemption above par. Later, in 2015, the majority of the PT Group was sold to Altice, while PTIF remained a subsidiary of Oi, S.A. When the Oi group filed for insolvency, the bonds initially issued by PTIF became worthless. Certain clients argued they were not informed of the corporate event and that if they had been informed they would have chosen to redeem their bonds. The courts have been rendering decisions holding that financial intermediaries in execution-only cases (even when they are custodians) do not have to inform clients of events subsequent to the investment. However, in 2019 the Lisbon Court of Appeal rendered a decision that had the following summary:

In the course of the execution of a contract for the deposit and registration of financial instruments, the financial intermediary and custodian cannot alienate themselves from changes relating to the entity that issued the bonds nor from those relating to the maturity date of the products, factors which are capable of negatively impacting the outcome and solidity of the products, and should inform the investor in such a way as to allow him or her to adopt, in due course, conduct that minimises or prevents risks which are known and are not negligible, and which threaten the normal conservation and coming to fruition of the financial instruments.\(^1\)

This decision was often referred to by those who argued that the banks should have informed the bondholders that a change in the issuer had been approved. However, a closer look at the decision reveals that, in fact, the court only accepted this duty as a plausible legal outcome to justify the decision to ask the lower court to further investigate certain facts, but directly stated that it did not wish to anticipate a ruling on that issue.

In a decision subsequently rendered on 24 October 2019, the same Court of Appeal decided that:

In the execution of a contract for the deposit and registration of financial instruments of ‘deposits of simple custody’, the financial intermediary is not obliged to communicate to the client, now the claimant, any change in the quotation – be it of appreciation, devaluation, or events that could determine these – of the securities of which it was the depositary, when they only reflect the materialization of a risk specific to the subscribed financial product, under the provisions of article 312º C, nº 1 of CVM.\(^2\)

resolution measure, similar to that applied to BES. This time, the relevant resolution measure involved the splitting of the bank into three: the good bank, which retained the business and the majority of the assets that were sold to Banco Santander Totta; some assets with potential for recovery, which were attributed to Oitante; and the bad bank. The latter was left with all liabilities to shareholders and subordinated creditors. Prior to the public intervention, Banif’s subordinated debt had also been issued to retail investors.

\(^1\) Decision of 8 January 2019, Proceeding No. 2115/17.7T8VFX.L1.7.
\(^2\) Decision of 24 October 2019, Proceeding No. 14027/17.0T8LSB.L1-6.
From a regulatory and supervisory standpoint, proposals for improving the effectiveness of said supervision – as well as significant reinforcement of the powers of Portuguese regulators over the financial sector, with a view to strengthening their capacity and effectiveness – were discussed last year, but have yet to be approved.

VI OUTLOOK AND CONCLUSIONS

The repercussions of the financial crisis, the GES/BES crisis and the Banif resolution measure have significantly influenced securities litigation in Portugal. Although the number of new judicial proceedings has decreased, public discussion regarding the liability of banking institutions indicates that it will continue to be a trend.

Indeed, the GES/BES crisis, the Banif resolution and the PTIF bond problem have generated a substantial number of disputes in the past few years, most of which are currently still pending in the first-instance courts. We expect that the outcome of these disputes will determine the scope of securities litigation in Portugal in the years to come. In the meantime, we anticipate that securities litigation brought by investor associations, retail investors, shareholders and subordinated creditors against the banks and their directors will continue to be a growing trend.

The final outcome of the litigation against the Bank of Portugal, challenging the retransfer decision by Novo Banco/BES, and the Banif resolution measure, also pending, is highly likely to shape future litigation in this area, as well as any resolution measures.

Lastly, administrative offences proceedings relating to securities transactions continue to be brought by the CMVM and the Bank of Portugal against numerous entities, and there appears to be no clear end in sight.
Chapter 15

RUSSIA

Sergey Yuryev

I OVERVIEW

i Sources of law

The Russian securities market only started to develop at the beginning of the 1990s, inspired by mass privatisation in Russia and by the creation of numerous joint-stock companies. The market started to form without any legislative base or key institutions (no stock exchanges, regulatory institutions, etc.), which did not allow for its proper functioning. Thus, the creation of the principal structures of the market was reactive and reflected the particular requirements of the market at that particular time.

This led to a situation in which the Russian legislation regulating the securities market was sometimes fragmentary and ambiguous; however, in recent years, the vast majority of the problems have been successfully eliminated by legislation and market practices.

Securities regulation in Russia is still at a formative stage and may change relatively quickly in response to market practices and state intentions.

Regulations governing the securities market in Russia consist of various legislative acts, governmental and presidential decrees, and ministerial directives, as well as numerous orders of the Central Bank of the Russian Federation (CBR) and other ‘sub-legislative’ acts.

The key legislation establishing the grounds for the securities market is the Civil Code of the Russian Federation (the Code). The Code establishes the basic principles of the securities market, including the types of securities, transfer of title for securities, etc. The Code also contains detailed regulations in respect of certain securities (warehouse certificates, warrants, etc.).

The Federal Law on the Securities Market No. 39-FZ of 22 April 1996 (the Law) contains detailed regulations on the securities market. The Law establishes that the CBR is the main regulatory body for the securities market (previously it was the Federal Commission for the Securities Market). The Law, inter alia, creates the framework for the securities market, establishing regulatory structure, defining the types of securities, their issuance and trading requirements, defining securities market participants and related requirements.

The Federal Law on Protection of Rights and Interests of Investors in the Securities Market No. 46-FZ of 5 March 1999 (the Protection Law) provides for various limitations on the operation of the securities market and on securities market participants to ensure the proper protection of various groups of investors, and minimising the possibility of market abuse.

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The Federal Law on Counteracting Illegal Use of Insider Information and Market Manipulation No. 224-FZ of 27 July 2010 was adopted to establish fair trading and fair market prices for securities, and to counteract market abuse.

The Federal Law on Attraction of Investments with Use of Investing Platforms No. 259-FZ dated 2 August 2019, which came into force from 1 January 2020, sets forth regulatory frameworks for investing in digital rights in Russia.

Various rules applicable to the securities market are contained in the Law on Joint Stock Companies, the Law on Competition Protection and the Law on the Central Bank of Russia, among others.

ii Regulatory authorities

As noted, the major authority regulating the securities market in Russia is the CBR (also known as the Bank of Russia).


The CBR, inter alia, is responsible for the following:

a developing and implementing mandatory rules for the securities market and its participants;
b exercising regulatory control over participants in the securities market;
c ensuring effective operation of the securities market; and
d protecting the rights and interests of securities market participants.

The CBR became responsible for the securities market as of 1 September 2013 pursuant to the Decree of the President of the Russian Federation No. 645 of 25 July 2013. Previously this sphere was regulated by the Federal Service for the Securities Market, which was abolished pursuant to the above-mentioned presidential decree, and all functions of the Federal Service for the Securities Market were transferred to the CBR. However, there are numerous regulatory acts issued by the Federal Service for the Securities Market still in force, governing various aspects of securities market operations.

The CBR is the main authority in the sphere of administrative liability for the participants in the securities market.

Responsibility for enforcing securities market regulations in the criminal sphere is vested in the Investigative Committee of the Russian Federation and in the Ministry of Internal Affairs of the Russian Federation, depending on the type of the crime.

Self-regulatory organisations are also an essential part of the regulatory framework, establishing their own rules and enforcing compliance with these rules by their members.

iii Common securities claims

Under Russian law, any party who suffers harm or loss because of wrongdoing has a right to be compensated in full by the party who committed the wrongdoing. Although most securities abuses are investigated and arraigned by the CBR, the CBR does not compensate private parties for their harm or loss and, in the vast majority of cases, the injured party has to initiate a separate civil claim with an applicable court or intervene in the criminal case (if one has been initiated) and seek damages within that criminal case as a ‘civil law defendant’.

Generally, Russian law establishes the following types of liability for wrongdoing in the securities market: administrative liability, criminal liability and civil liability.
Administrative liability is established by the CBR for various market violations pursuant to the provisions of the Law and various regulatory acts, and also on the basis of the provisions of the Code on Administrative Offences of the Russian Federation (the Administrative Code). Under the Administrative Code, Russian law distinguishes the following major types of administrative offences in the securities market:

- administrative offences in respect of dealing with the securities, which includes liability for wrongdoing related to the issuance of securities, illegal operations with the securities, interfering with performance of the rights granted by securities, violation of the rules regarding purchase of 30 per cent or more of the share capital of an enterprise, etc.;
- administrative liability for ‘information disclosure’ in the securities market, which includes liability for failure to comply with the regulatory requirements for securities market participants to provide timely and accurate reports; for providing false or misleading information in those reports; for intentionally omitting certain information, etc.;
- administrative liability for abuses relating to insider information and market manipulation;
- administrative liability for violation of the rules in respect of depositaries and register holders;
- administrative liability for violation of the rules in respect of shareholders’ meetings in public joint-stock companies; and
- administrative liability for violation of the rules of the securities market applicable to various professional participants in the securities market.

All the above administrative offences are investigated and enforced by the CBR. Criminal liability is also contemplated for most of the above offences in the event of substantial damage or loss, in which case the offences are investigated and enforced by the investigating authorities in charge.

Cases in respect of illegal insider trading and market manipulation are not very common in Russia. According to the CBR statistics, there were 107 such cases initiated in the period 2010–2020, most of which were for market manipulation (with only six cases for insider trading for the above-mentioned period).

The most common civil law claims in Russia in respect of the securities market may be divided into the following categories:

- contractual claims: claims arising out of sale-purchase contracts, claims against depositaries and register holders, claims to utilise the rights related to the securities, etc.;
- claims invalidating certain transactions;
- claims for compensation of damage or loss (claims in respect of insider trading, market manipulation and information disclosure may be included in this category); and
- other claims.

The level of insider trading claims and market manipulation cases is attributable to the non-effective legislation regulating such claims.

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II PRIVATE ENFORCEMENT

i Forms of action

The form of actions for private enforcement of securities claims may be either an individual action or a joint action.

Since 1 October 2019, the concept of joint actions has been fully implemented into Russian law and may be used in disputes regarding securities. Under the new procedure, individuals with a similar claim (e.g., a claim to the same securities issuer arisen from the same issuer’s misconduct) will be able to unite together or with organisations into a group of at least 20, select a representative from the group and file a lawsuit against a respondent. It can potentially be an efficient tool for protection of investors’ rights. Therefore, the growth of joint actions in respect of securities may be expected in the near future.

Normally an individual claim in a securities dispute is filed with the arbitration court at the location of the defendant. The claim is filed pursuant to general provisions of the Russian Arbitration Procedure Code (APC). Burden of proof and defences available generally depend on the provisions of the law involved, but, following the principles of the APC, normally each party bears its burden of proof and shall fully support its case with evidence.

Alternatively the claim may be initiated within a criminal case trial, where the injured party acts as a civil law defendant, seeking the award of damages.

Since 1 February 2017, most corporate disputes have been considered as unconditionally or conditionally arbitrable. Unconditionally arbitrable disputes may be settled by commercial arbitration bodies authorised as a permanent arbitration institution under Russian law (i.e., not ad hoc arbitration) provided that all parties have entered into the arbitration agreement after 1 February 2017. This category of disputes includes cases connected with disputes related to ownership of shares, sale-purchase of shares and others. In addition to the above provisions, conditionally arbitrable disputes (e.g., disputes connected with issuance of securities) shall be settled in the territory of the Russian Federation under special rules of corporate disputes approved by an arbitration institution, deposited in the Ministry of Justice and published on the arbitration institution’s website. At present, however, there are only five arbitration institutions entitled to consider corporate disputes in Russia.

ii Procedure

As noted, the filing of the claim and general procedure is the same as for other claims filed under the terms of the APC with arbitration courts. The claimant should file a written and signed statement of claim, which should contain a mixture of alleged fact and law, coupled with details of the evidence that the claimant proposes to adduce at trial. Mandatory pretrial dispute settlement does not apply to corporate disputes, including disputes relating to securities. The judge is responsible for preparing a case for trial, and will question the parties in an attempt to clarify the issues in dispute between them.

There is no pretrial disclosure per se in Russian legislation. Russian procedural legislation does not provide any special regulation similar to the discovery or disclosure procedure in the United Kingdom or the United States; because of fundamental differences in procedure law,
a Russian court has a much more significant role in the court hearing and the examination of evidence. Each party has to prove its case based on the documents available to it. If any evidence is in the possession of other parties (including participants in the case), a party may petition the court to obtain the evidence from the party, and such petitions are normally granted.

Subject to the procedural legislation, evidence is considered as being legally obtained information about the facts constituting the claims and objections of the parties, as well as other circumstances that are important for the correct examination and resolution of the case. This information may be obtained by the court by means of:

- explanations by the parties or third persons;
- testimony of witnesses;
- written or material evidence;
- audio and video materials; and
- expert examination.

No evidence may have its force established in advance. The court will assess the relevance, admissibility and authenticity of all evidence, as well as its sufficiency and interconnection.

Each party must prove the circumstances it refers to within the claim or objection. However, it is the court that determines which circumstances are relevant to the case and which party successfully proves it. The court may also propose that the parties bring additional evidence.

Explanations by the parties or third persons concerning the circumstances necessary to resolve the case are checked and evaluated like any other evidence. Thus, these explanations do not take precedence over other evidence such as witness or material evidence. In addition, if the party acknowledges any facts constituting the claim of the counterparty, the latter does not have to prove this later on.

Russian arbitration courts rarely rely on witness statements and written witness testimonies, relying mostly on documents and written evidence.

Judgment will be given orally and in writing, normally within a week of the oral decision being announced.

Decisions of the first instance arbitration court become enforceable after one month, and during this time a party has a right of appeal, on fact or law, to the appeals instance. The decision of the court of the appeal instance is further appealable to the court of cassation. The final court of appeal is the Russian Supreme Court, which has a supervisory appellate function (empowering it to revise the decision of any state arbitration court that is illegal or lacking in legal substance).

The costs of litigation include a court fee plus the costs related to the trial of the case. The losing parties are usually ordered to pay the winner’s costs. Legal costs of the winning party may also be collected, but at a ‘reasonable’ level at the discretion of the judge.

iii Settlements

Settlement may be reached at any stage of arbitration proceedings, including at the enforcement stage. The court considering the case is usually trying to force the parties to reach a settlement.
Russia

A settlement is usually formalised through a court-approved settlement agreement, which has the force of a court decision. The settlement shall also contain the provisions on allocation of court expenses and fees of each party, and in the absence of these provisions the court shall allocate the expenses by itself and reflect this in its ruling approving the settlement.

The settlement agreement may not affect the rights and obligations of third parties (including other participants in the securities market), otherwise it will not be approved by the court. For the settlement, the parties may use mediation proceedings, but such proceedings are very rarely utilised, as mediation results do not have mandatory and binding effect pursuant to Russian legislation.

iv Damages and remedies
Compensation for damage or loss caused by the violation of a right is a general tool of protection under Russian law. A person whose rights were violated may demand full compensation for damage or loss incurred. Both material and non-material damages may be collected (i.e., compensation for pain and suffering for individuals, or loss of business reputation for legal entities). Normally the full amount of direct damages shall be collected, although non-material damages are usually awarded at the discretion of the courts and are of nominal value. The claimant shall prove the amount of claimed damages by means of relevant documents.

Damages to recover loss of profit can be claimed, but are difficult to prove in court. The courts are reluctant to award large amounts of damages in relation to loss of profits.

Other remedies are also available (performance in kind, orders to perform certain acts or refrain from certain steps, etc.).

III PUBLIC ENFORCEMENT

i Forms of action
The CBR has quite broad authority to supervise the securities market and to investigate any activities of its participants. It is necessary to mention that the CBR’s authority to supervise the securities market is provided by the administrative legislation (the Administrative Code), as well as by the general legislation on the securities market and its regulation (the Law, the Protection Law, other legislative acts), so the CBR has a wide variety of tools to regulate the market and prevent market abuses.

An investigation may be initiated by the CBR either on its own initiative on the basis of market supervision or received reports, or in response to any complaint from a market participant or any other person.

If, following an initiated investigation, the CBR finds any wrongdoing, it has the authority to initiate administrative proceedings and issue corresponding orders (or, depending on the amount of the loss or damage, pass the case for consideration to the investigating authorities in charge for initiation of a criminal case). Orders of the CBR may be appealed to relevant courts pursuant to the terms of the Administrative Code.

The CBR has the right to issues fines or petition the applicable court for disqualification of individuals responsible for the wrongdoing, or impose both these sanctions. The CBR is also entitled to use other coercive measures as provided by securities legislation:

a request documents for investigations in process;

b issue mandatory orders to participants in the securities market;
issue orders prohibiting (or limiting) certain operations on the securities market for a period of up to six months; and

prohibit issuance of certain securities, etc.

ii Procedure

As noted, the CBR on its own initiative or upon a complaint initiates first a preliminary investigation, and if there are grounds to believe that wrongdoing was committed, the CBR starts a formal investigation. Once the formal investigation is initiated, the CBR has the power to proceed with certain coercive measures as indicated above to conduct and finalise the investigation, as well as to prevent ongoing wrongdoing, by issuing mandatory orders to the participants in the securities market.

Once it has reached its final conclusion in respect of the wrongdoing, the CBR may either close the case, undertake certain measures to prevent further wrongdoing, issue administrative fines or apply to the court for disqualification of certain individuals responsible for the wrongdoing (or both), or transfer the case for the consideration of the investigating authorities in charge if the amount of damage or loss caused by the alleged wrongdoing is substantial and exceeds certain statutory established thresholds (for each wrongdoing).

The alleged wrongdoer may participate in the CBR investigation, submit its explanations and objections, provide relevant documents in support of its position and further appeal the decision of the CBR to the relevant court.

The proceedings in the court are conducted pursuant to the Administrative Code. Usually the proceedings are fast and efficient.

The decision of the court of first instance may be appealed to the corresponding appellate division within one month of the decision being issued in full. The decision of the appellate instance may be further appealed to the court of cassation.

If the CBR transfers the case to the investigating authorities in charge because the wrongdoing may be considered a criminal offence, the corresponding authority conducts its own investigation and, depending on the results of a preliminary case assessment, it may initiate a criminal case.

iii Settlements

Settlements in administrative cases are possible as well. The settlement in administrative proceedings may relate only to the rights and obligations of the parties to the dispute (settlement may not affect the rights and obligations of third parties and other participants in the securities market).

The settlement is fixed by a court-approved agreement, defining the rights and obligations of the parties. Upon approval of the settlement by the court, the administrative case proceedings shall be terminated in full (or in part, if settlement relates to a particular aspect of the dispute).

The court-approved settlement in administrative proceedings has the power of a valid and binding court decision and may be enforced accordingly.

Settlements with the CBR are not very common (nor are settlements with other administrative authorities), as Russian officials are concerned about potential accusations of corruption and thus tend to leave cases for final and ultimate consideration by the courts.

Settlements in criminal cases are also possible pursuant to Article 25 of the Criminal Procedure Code of the Russian Federation. The settlement is possible under the following conditions:
the settlement is possible only for ‘small- and mid-gravity’ crimes (deliberate malicious wrongdoing with punishment of no more than five years of imprisonment or reckless acts as contemplated by the Criminal Code of the Russian Federation (the Criminal Code));

b the accused individual has never been criminally accused before;

c the accused individual is reconciled with the injured party and has fully compensated the damage;

d the injured party has filed a special motion asking for termination of criminal proceedings; and

e the accused individual does not object to terminating the criminal proceedings.

Further, Russian legislation specifically provides the possibility of termination of criminal proceedings for certain economic crimes, which includes most criminally punishable wrongdoings in the securities market. Pursuant to Article 76.1 of the Criminal Code, criminal proceedings shall be terminated in respect of the crimes committed in the securities market under the following terms:

a the accused individual has never been criminally accused before;

b the accused individual has fully compensated the damage done to the injured party; and

c the accused has paid to the state budget double the amount of the damage or loss caused (or paid to the state budget the amount of income received as a result of the wrongdoing plus double the amount of that income).

Again, as in administrative proceedings, criminal investigators are reluctant to settle cases out of concern about corruption allegations; however, the settlement may be reached in court.

iv Sentencing and liability

Under the Administrative Code, Articles 15.17–15.24.1 and 19.7.3 are devoted to administrative wrongdoing in the sphere of securities. The following liability is provided:

a illegal securities operations (transactions performed prior to the proper registration of the securities): fines for responsible managers of up to 10,000 roubles (or criminal liability) and fines for legal entities of up to 500,000 roubles;

b violations in the sphere of disclosure of information in the securities market (non-disclosure, insufficient disclosure, false information, failure to comply with time frames or follow prescribed procedures): fines for responsible managers of up to 30,000 roubles (or criminal liability) or disqualification (prohibition on holding certain management positions) for up to a year, and fines for legal entities of up to 700,000 roubles;

c failure to make due and timely reports to the CBR: fines for responsible managers of up to 30,000 roubles or disqualification (prohibition on holding certain management positions) for up to a year, and fines for legal entities of up to 700,000 roubles;

d limitations on the use of securities and affecting the rights pertinent to the securities: fines for responsible managers of up to 30,000 roubles (or criminal liability), and fines for legal entities of up to 700,000 roubles;

e illegal use of insider information: fines for individuals of up to 5,000 roubles, fines for responsible managers of up to 50,000 roubles (or criminal liability) or disqualification
(prohibition on holding certain management positions) for up to two years, and fines for legal entities equal to the amount of the profit received as a result of the illegal use of the insider information (or losses avoided), but not less than 700,000 roubles; and violations in the sphere of maintaining securities registers: fines for responsible managers of up to 50,000 roubles (or criminal liability) or disqualification (prohibition on holding certain management positions) for up to two years, and fines for legal entities of up to 1 million roubles.

Other fines for administrative wrongdoing in the securities market do not differ materially from the fines indicated above.

The Criminal Code shall be applicable (Article 185 of the Criminal Code) if the cost of damage or losses (or illegal income) arising from wrongdoing in the securities market exceeds 1.5 million roubles (large damage) or in certain cases 3.75 million roubles (extra-large damage).

The Criminal Code provides various sanctions for aggravated crimes (conspiracy, crimes committed by organised groups, with large or extra-large damage, etc.). The most serious sanctions are as follows:

- **a** abuses in the issuance of securities (large damage) (failure to disclose information upon issuance and registration of securities, placement of securities prior to registration, etc.): fines of up to 500,000 roubles or three times the annual income of the accused, or imprisonment of up to three years;
- **b** abuses in disclosing information (large damage): fines of up to 300,000 roubles or two times the annual income of the accused, or imprisonment of up to two years;
- **c** market manipulation if the cost of damage or losses exceed 15 million roubles: fines of up to 1 million roubles or five times the annual income of the accused, or imprisonment of up to seven years with a fine or without one and disqualification for three years; and
- **d** illegal use of insider information (or illegal transfer of such information for subsequent illegal use) (extra-large damage): fine up to 1 million roubles or four times the annual income of the accused, or imprisonment of up to six years with a fine or without one and disqualification for four years.

**IV CROSS-BORDER ISSUES**

Russian securities regulations apply exclusively to the Russian securities market and Russian state authorities (including the CBR) have jurisdiction only for market abuses that occur in the Russian securities market.

Similarly, the Russian state criminal authorities and Russian criminal law apply only to crimes committed entirely (or partially) in Russia.

Foreign investors operating in the Russian securities market become subject to Russian legislation and shall follow the Russian law requirements as discussed above.

Russian arbitration courts have the authority to consider cases with the participation of foreign parties for the following disputes:

- **a** in respect of depository activities and the registration of title for securities in Russia;
- **b** if the dispute is in respect of property located in Russia belonging to a foreign company;
- **c** corporate disputes;
- **d** if the dispute is based on an agreement according to which the performance shall be in Russia;
if the damage occurred in Russia; and

disputes in respect of securities registered in Russia.

V YEAR IN REVIEW

As discussed, Russia has not yet reached the stage where securities legislation has developed into a solid and consolidated set of rules and practices, with substantial supporting court practice and legislative guidance. Despite a lot of amendments to the corporate and securities legislation, it is still in a transitional stage, and it is quite fragmentary and sometimes controversial.

We do note, however, an increasing number of securities disputes as a result of the development of the securities market, and following this the CBR and legislators have introduced some guidance on the existing legislation, detailing the rights and obligations, and increasing liabilities, under the securities market legislation.

VI OUTLOOK AND CONCLUSIONS

In view of the current political environment and sanctions against Russia, to become more attractive to foreign investors, the Russian government recently introduced a corporate law reform that is the most significant development since the establishment of modern corporate law in Russia. The legislator’s rationale behind the reform of corporate law is to create a more favourable and democratic environment for businesses, while at the same time taking into account the rights and interests of creditors, participants or shareholders and the companies themselves. New legislative mechanisms have also been designed to increase the attractiveness of Russian joint ventures for foreign investors.

More changes in the sphere of corporate legislation and the securities market are expected in 2020 and this will obviously affect the regulation of the securities market, ensuring more transparent rules and practices.

Current Russian legislation and CBR regulations ensure the basic minimum required standards for regulation of the securities market. This is especially true for the regulation of insider trading, market manipulation and prevention of various other securities market abuses in Russia. It is expected that the gaps that remain will be eliminated by the legislators and the CBR with the practical implementation of the very significant corporate law reform mentioned above.
I OVERVIEW

i Sources of law

The primary source of securities law in Singapore is the Securities and Futures Act (SFA). It is supported by a network of other statutes, regulations and guiding instruments. Case law precedents provide authoritative guidance for the interpretation and application of these legislative rules.

A list of the key sources is set out below.

Statutes (primary legislation)

a Securities and Futures Act (Cap 289, Rev Ed 2006).
b Companies Act (Cap 50, Rev Ed 2006).
d Banking Act (Cap 19, Rev Ed 2008).
e Insurance Act (Cap 142, Rev Ed 2002).

Regulations (subsidiary legislation)

a Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2018.
b Securities and Futures (Organised Markets) Regulations 2018.
c Securities and Futures (Licensing and Conduct of Business) Regulations (Rev Ed 2004).
d Securities and Futures (Trade Repositories) Regulations 2013.
f Companies Regulations (Rev Ed 1990).

Other instruments

The Monetary Authority of Singapore (MAS) issues directions, codes and guidelines, and practice statements and notes, as follows:

a Written directions issued by the MAS: these directions have the force of law, a breach of which may constitute a criminal offence.
b. MAS Codes & Guidelines (e.g., the Singapore Code on Take-overs and Mergers, and the Code on Collective Investment Schemes): these are non-statutory instruments that provide guiding standards that market participants should adhere to.

c. No-action letters: while useful as guidance, these letters do not have the force of law as they do not bind the MAS or the Public Prosecutor from instituting proceedings subsequently.

d. Policy statements and practice notes: when a market participant presents certain facts to the MAS for its opinion, the MAS may issue a no-action letter to state that it does not intend to institute proceedings against the market participant on the basis of those facts. The MAS may subsequently issue a policy statement or practice note to inform all market participants on the practice it has adopted.

The Singapore Exchange (SGX) has issued the following rules:


c. The SGX-ST Rules.

d. The SGX-DC Clearing Rules.

e. The Futures Trading Rules.

ii Regulatory authorities

Civil authorities

The MAS is the primary regulator of the banking, insurance and securities industries. It also performs the functions of the central bank of Singapore.

The SGX is the front-line regulator for all listed companies and trading activities on the exchange.

In relation to mergers and acquisitions, the Securities Industry Council is responsible for administering and enforcing the Singapore Code of Take-Overs and Mergers.

Criminal authorities

The Commercial Affairs Department of the Singapore Police Force is primarily responsible for the investigation and prevention of financial and other white-collar crimes.

The Financial and Technology Crime Division of the Attorney-General’s Chambers is primarily responsible for the prosecution of financial and other white-collar crimes.

iii Common securities claims

Securities claims in Singapore generally take the form of common law claims or statutory claims under the SFA.

Common law claims can be based on various grounds, including (but not limited to) breach of contract, misrepresentation and breach of fiduciary duties.

The statutory claims are primarily found in Part XII of the SFA. They include:

a. insider trading;

b. false trading;

c. market manipulation;

d. market rigging;

e. dissemination of false or misleading statements and information;

f. employment of manipulative and deceptive devices;
failure to provide continuous disclosure of material information;

fraudulently inducing persons to deal in capital markets products; and

dissemination of information about illegal transactions.

A breach of any of the above can attract both civil and criminal consequences.

Many of these securities claims overlap – it is common for the same factual matrix to give rise to multiple securities claims. For instance, the prosecution for insider trading is typically accompanied by a prosecution for the failure to provide continuous disclosure of material information.

The SFA provides for a concept of ‘attributed liability’ – if an officer or a corporation is found to have committed one of the relevant statutory offences with the consent or connivance of the corporation and for the corporation’s benefit, the corporation will be guilty of that offence as if it had committed that offence itself.

The SFA also provides that if an offence under the SFA is found to have been committed by a corporation with the consent or connivance of, or to be attributable to any neglect on the part of an officer, both the officer and the corporation would be guilty of that offence.

Additionally, the general principles of criminal accessory liability (i.e., conspiracy or abetment, or both) apply – broadly speaking, it would have to be shown that the person had a sufficient degree of knowledge that the offence would be committed.

II PRIVATE ENFORCEMENT

Forms of action

Nature of proceedings

Private actions can be commenced by writ of summons or originating summons. The latter is generally limited to proceedings that only concern questions of law and do not involve substantial disputes of fact.

Availability of class action suits

Singapore law does not recognise class action lawsuits in the sense that is traditionally understood in the United States. However, it does allow a single person to commence a proceeding on behalf of various persons who have the same interest. This process is referred to as ‘representative proceedings’. Separately, multiple suits that pertain to the same transaction or involve common questions of fact or law can also be consolidated into a single suit.

Shareholder derivative action

A shareholder derivative action can be commenced either as a statutory derivative action under the Companies Act or as a common law derivative action. It is generally easier to commence a statutory derivative action, as the threshold requirements are less onerous. However, statutory derivative actions may only be commenced by companies incorporated in Singapore – there is no such restriction for common law derivative actions.
**Procedure**

**Court system**

The general rules relating to the jurisdiction of the Singapore courts apply to securities claims. Where the quantum of a claim exceeds S$250,000, it will be heard in the first instance in the High Court. Where it does not, it can be heard in the state courts.

If the case is transnational in nature, it may be heard in the Singapore International Commercial Court (SICC) if certain requirements are met.

There is a specialist list of judges who will generally hear securities and financial matters. Currently, all civil appeals from the High Court and the SICC are heard by the Court of Appeal. In November 2019, the Singapore parliament passed legislative amendments (which are not yet in force) to restructure the High Court into the General Division of the High Court and the Appellate Division of the High Court. Under this new framework, the Court of Appeal will continue to be the apex court. However, civil appeals from the General Division of the High Court will generally be heard by the Appellate Division, save for specified categories of cases (including cases relating to the law of arbitration, insolvency and restructuring cases, and SICC decisions) which will be heard by the Court of Appeal. Any further appeal against the decision of the Appellate Division may be brought only with the leave of the Court of Appeal. The new framework aims to enhance the efficiency and flexibility of court processes.

**Civil procedure rules**

The civil procedure rules relating to service, pleadings, discovery, pretrial procedures, conduct of trials, and appeals are the same as in any other private law action. These can be found in the Supreme Court of Judicature Act, the State Courts Act, the Rules of Court and the Practice Directions of the respective courts.

A public consultation exercise on major reforms to Singapore’s civil procedure regime was completed in 2019. It remains to be seen what legislative amendments will be introduced and how they will impact securities litigation in Singapore.

**Financial Industry Disputes Resolution Centre**

Apart from securities litigation in the courts, it is common for financial services disputes to be resolved by alternative dispute resolution (ADR) in the Financial Industry Disputes Resolution Centre (FIDReC).

FIDReC is an independent institution set up to provide ADR services for financial disputes in Singapore. Access to FIDReC is available to retail investors with a claim against financial institutions, limited to S$100,000 per claim (unless agreed otherwise).

When a dispute is referred to FIDReC, it will first direct parties to resolve their dispute by mediation. If mediation fails, the case will be heard by way of adjudication. The decision of the adjudicator is binding on the financial institution, but not on the retail investor.

**Settlements**

**Entering into settlement**

The general principles relating to the settlement of a securities claim are no different from those relating to settlement of other types of claims. Settlement agreements generally take the form of a contract or a deed.
The parties are generally free to agree on the terms of the settlement and the courts would not intervene save in exceptional circumstances. There is no need for the court to endorse the settlement agreement, though it is possible for parties to record the terms of the settlement agreement by entering it as a consent order.

**Costs**

In the event of a settlement, there is no requirement for attorneys’ fees to be fixed by the court – parties are free to agree on their costs.

However, if a settlement offer is made by one party and the other party does not accept it, there may be costs implications for the latter party depending on the outcome of the trial. Under Singapore’s civil procedure rules, where a plaintiff’s offer to settle is rejected and the plaintiff subsequently obtains a court judgment equal to or more favourable than the terms of the offer, the plaintiff is entitled to its legal costs on an indemnity basis from the date of the offer to the date of the judgment.

Conversely, where a defendant’s offer to settle is rejected and the plaintiff subsequently obtains a judgment that is equal to or worse than the terms of the offer, the court may award the defendant costs on an indemnity basis.

**Breach of settlement agreement**

Where one party acts in breach of the settlement agreement, the possibility of the other party bringing a claim based on the facts existing prior to settlement (as opposed to a claim based on the settlement agreement alone) depends on the terms of the settlement agreement.

**iv Damages and remedies**

The primary remedy awarded in securities claims, as in other claims, is damages. The calculation of damages depends on the exact nature of the claim, though the general principle behind an award of damages is to compensate the plaintiff for its losses.

If the claim is contractual in nature, the standard measure of damages will be the amount needed to place the plaintiff in a position as if the contract had been performed. If the claim is tortious in nature, the standard measure of damages will be the amount needed to place the plaintiff in a position as if the tort had not been committed.

Where there has been a contravention of the SFA, investors who have suffered losses as a result of the contravention are entitled to make claims against the contravening person. The amount of compensation that a claimant is generally entitled to is its loss suffered by reason of the difference between the price at which the securities were dealt in contemporaneously and the price at which the securities would likely have been so dealt in at the time of the contemporaneous dealing if there had been no contravention (or where insider trading is concerned, the inside information had been generally available). However, the maximum recoverable amount is the amount of profit gained or the amount of loss avoided by the contravening person. The court will pro-rate this amount if there are multiple claimants.

Non-monetary remedies, such as orders for specific performance and injunctions, may be awarded where damages are inadequate to compensate the plaintiff for its loss. The court will consider all the circumstances to decide whether to award such remedies, including whether the plaintiff itself is guilty of any blameworthy conduct.
III PUBLIC ENFORCEMENT

i Forms of action

**Powers of the SGX**

The SGX has the power to impose various sanctions, such as public reprimands, fines, restriction of access to market facilities, suspension and delisting.

**Powers of the MAS**

A range of enforcement actions is available to the MAS, including issuing warnings and reprimands, offering composition, issuing prohibition orders, directing the removal of directors and officers, and revoking or suspending the regulatory status of the financial institution.

Where appropriate, enforcement proceedings may also be commenced against the defendant. This can be done in one of two ways. The first is for the MAS to refer the matter to the Attorney-General Chambers (AGC), which can then decide to commence criminal proceedings.

Alternatively, the MAS may pursue enforcement proceedings under the civil penalty regime. Under this regime, the MAS may, with the consent of the AGC, commence civil proceedings against the defendant to seek a civil penalty.

Where the MAS has successfully pursued enforcement proceedings under the civil penalty regime, the court will not allow criminal proceedings to be brought against the same contravening person on the same subject-matter.

ii Procedure

The MAS will first investigate the matter to decide whether further action should be taken. The powers of the MAS have been set out above.

**Criminal proceedings**

Where the matter is referred to the AGC, it has the discretion as the public prosecutor to decide whether or not to commence criminal proceedings. The conduct of criminal proceedings involving securities-related offences is similar to that of criminal proceedings involving other types of criminal offences.

The accused would first be charged in court and then be asked whether he or she pleads guilty. A guilty plea must be made by the accused personally, voluntarily and without qualification. The court must also be satisfied that the accused understands the nature and consequences of his or her plea and the punishment prescribed for the offence, especially where he or she is unrepresented.

If the accused pleads guilty, the matter would be referred for sentencing. If the accused pleads not guilty, the matter will proceed to trial.

Prior to the trial, the prosecution has a duty to disclose to the accused (1) any unused material that may reasonably be regarded as credible and relevant to the guilt or innocence of the accused; or (2) any unused material that provides a real chance of pursuing a line of inquiry that leads to (1).

During the trial, the prosecution will first present its case, which will include the examination of its witnesses. After the prosecution examines each of its witnesses, the defence would have the opportunity to cross-examine him or her. After the prosecution closes its case, the defence will present its case in similar fashion.
The court will only convict the accused if it is satisfied, having heard all the evidence, that all the elements of the offence are made out beyond a reasonable doubt. Otherwise, the accused will be acquitted.

**Proceedings under the civil penalty regime**

If the MAS decides to pursue civil proceedings under the civil penalty regime, the procedure would generally follow that of all other civil proceedings heard before the High Court.

Proceedings are commenced by the MAS making a claim against the contravening person, who will then have to enter an appearance in court and file a defence if he or she intends to dispute the claim. Thereafter, discovery will take place (during which all relevant documents must be disclosed) and affidavits of evidence-in-chief would be filed. The matter would then proceed to trial.

In contrast to criminal proceedings where a higher burden of proof applies (i.e., beyond a reasonable doubt), the burden of proof in proceedings under the civil penalty regime would be that of the civil standard (i.e., balance of probabilities).

### iii Settlements

**Criminal proceedings**

As with all criminal proceedings, the prosecution has the discretion to proceed with a lesser charge or withdraw the charge entirely. The accused may also decide to plead guilty to the charge at any stage of the criminal proceedings, though the sentence imposed by the court would generally be higher where the accused pleads guilty at a later stage.

Where the accused is a company, partnership, limited liability partnership or an unincorporated association, the prosecution may decide to enter into a deferred prosecution agreement (DPA) with the accused in lieu of prosecution. A DPA is a voluntary agreement under which the prosecution agrees not to prosecute a corporation in exchange for the corporation agreeing to fulfil certain conditions and requirements within a fixed duration. Such conditions could include payment of a financial penalty, implementation of a compliance programme and cooperation in investigations.

The DPA framework is intended to enable authorities to investigate large-scale, complex corporate crimes, and help bring culpable individuals to justice. It assists the prosecution in taking further action against culpable individuals (in this regard it should be noted that the DPA scheme does not apply to the individual officers) while avoiding costly investigations and litigation.

The DPA framework only applies to scheduled offences, including certain offences under the Corruption, Drug Trafficking and Other Serious Crimes (Confiscation of Benefits) Act, the Prevention of Corruption Act and the SFA.

All DPAs will need to be approved by the High Court. Approval will only be granted if the DPA is in the interests of justice and its terms are fair, reasonable and proportionate. To ensure transparency, DPAs must be published after they are approved by the court.

Where a DPA is entered into and approved by the court, the corporation is deemed to have been granted a discharge not amounting to an acquittal. After the expiry of the DPA, the High Court may grant a discharge amounting to an acquittal. If, however, the corporation breaches the terms of the DPA during its term, the prosecution can make an application to terminate the DPA and prosecute.
Proceedings under the civil penalty regime
The MAS has the power to enter into a settlement agreement with the contravening person to pay, with or without admission of liability, a civil penalty. The rules governing such a settlement agreement are the same as in a private action commenced by investors (see above). There is no requirement for the settlement agreement to be judicially endorsed by the court. Neither is there a need for attorneys’ fees to be fixed by the court.

iv Sentencing and liability

Criminal proceedings
Generally, a person who is convicted of market misconduct offences may be sentenced to a fine not exceeding S$250,000, imprisonment for a term not exceeding seven years, or both.

Civil penalty regime
Under the civil penalty regime, the court may order payment of a sum not exceeding three times the amount of profit that the person gained as a result of the contravention or three times the amount of loss that the person avoided as a result of the contravention, whichever is greater and subject to a maximum cap of S$2 million. However, where the person is a corporation, the payment ordered must in any event not be less than S$100,000. In any other case, the minimum payment that must be ordered is S$50,000.

In assessing the amount of profit gained or the loss avoided by the contravening person, the court may consider the difference between the price paid or received by the contravening person and the trading price of the securities had the contravention not been committed (except for insider trading where the court would take into account the price within a reasonable period after public dissemination of the information).

Consequential and other orders
Where the contravening person is convicted of an offence or ordered to pay a civil penalty, the court may fix a date on or before which all claimants have to file and prove their claims for compensation in respect of that contravention.

The court may also make an order against any other person who has received the whole or any part of the benefit of that contravention for disgorgement of that benefit, being benefit derived from trades carried out for the third party by the contravening person.

Where it appears that a securities-related offence has been or is about to be committed, the court has the power to make a range of orders, including restraining and mandatory orders and orders declaring that a contract relating to a capital markets product or financial benchmark is void or voidable.

IV CROSS-BORDER ISSUES
The SFA may potentially apply to foreign parties (including foreign issuers) as it has extraterritorial scope.

First, where a person commits an act partly in and partly outside Singapore, and that act constitutes an offence under the SFA, that person would be guilty of the offence as if the acts had been carried out wholly in Singapore.
Second, even where a person commits the offence outside Singapore, that person can be prosecuted and convicted of that offence in Singapore if the act has a substantial and reasonably foreseeable effect in Singapore.

The extraterritorial scope of the SFA as described above also applies to civil proceedings (including proceedings under the civil penalty regime) commenced in relation to insider trading and other forms of market misconduct.

In civil proceedings, where the defendant is a foreign party with no presence in Singapore, there may be difficulties in the service of the originating process and the subsequent enforcement of any judgment. As regards service, leave of the Singapore court would have to be obtained prior to effecting service of the originating process overseas. As to the enforcement of the Singapore judgment in the foreign jurisdiction, the ease of enforcement would depend on the laws and processes of the place of enforcement.

One issue that normally arises in cross-border civil disputes is the jurisdiction in which the dispute should be heard. In this regard, the inquiry starts with whether there is an applicable jurisdiction clause. Where the parties had agreed to an exclusive jurisdiction clause, the Singapore court would generally enforce that clause. Where the parties have agreed to a non-exclusive jurisdiction clause (in favour of Singapore), the Singapore courts would generally enforce the clause unless there is strong cause for not doing so. This is a very high threshold to meet.

If there is no applicable jurisdiction clause, then the Singapore courts would determine which forum (Singapore or the foreign jurisdiction) is the natural forum to hear the dispute, and the inquiry involves (but is not limited to) a consideration of which jurisdiction has the most real and substantial connection to the dispute. This is largely a question of fact and involves the consideration of multiple factors.

V YEAR IN REVIEW

i Legislative amendments


The Payment Services Act seeks to provide a forward-looking and flexible framework for the regulation of payment systems and payment service providers in Singapore, so as to strengthen consumer protection and promote confidence in electronic payments. It also seeks to provide a dual-track regulatory framework, with one intended for major payment institutions and the other designed for all other businesses providing payment services. This is intended to allow smaller payment firms the opportunity to innovate without being subject to all regulations.

The Variable Capital Companies Act introduces the variable capital company (VCC), a new corporate structure for investment funds. A VCC has several unique features that provide operational flexibility to fund managers. VCCs can be used for both open-ended and closed-ended alternative and traditional funds. A VCC can also be used as a single standalone fund, or as an umbrella funds with multiple sub-funds. Its shares are redeemable without shareholders’ approval, and dividends are payable from capital (and not only profits).

ii Recent judgments

Three cases relating to securities litigation that were recently decided by the Singapore courts are set out below.
The first case (Quoine Pte Ltd v. B2C2 Ltd [2020] SGCA(I) 2) is an appeal against the SICC’s judgment in the first cryptocurrency trial in Singapore. The defendant operates a currency exchange platform that enables third parties (including electronic market makers such as the plaintiff) to trade virtual currencies for other virtual currencies or for fiat currencies. The dispute arose out of trades that the plaintiff had entered into to sell ethereum for bitcoin. The defendant reversed the trades the following day after it discovered a glitch in its programme that resulted in the plaintiff’s trades being executed at a much more favourable rate to the plaintiff than the current market rate.

Following the defendant’s reversal of the trades, the plaintiff sued the defendant for breach of contract and breach of trust. The SICC allowed the plaintiff’s claims, holding that the defendant’s reversal of the trades constituted a breach of contract as the parties’ agreement was for trades to be ‘irreversible’. The SICC also held that the defendant acted in breach of trust, and in reaching this conclusion found that cryptocurrencies met all the requirements of a property right; and there was an intention to create a trust because the cryptocurrency assets were held separately from the defendant’s own trading assets.

On appeal, the majority of the Court of Appeal upheld the SICC’s decision in so far as the plaintiff’s breach of contract claim was concerned. However, as regards the plaintiff’s breach of trust claim, the court unanimously found that there was no intention to create a trust – the arrangement was more akin to deposits being made with a bank and the mere fact of segregation of assets did not in and of itself lead to the conclusion that there was a trust. Given this finding, the court found it unnecessary to consider whether cryptocurrencies constitute a species of property that is capable of being held on trust. It thus remains an open question in Singapore as to whether property rights exist in a cryptocurrency.

The second case (Cheong Chee Hwa v. China Star Food Group [2019] SGHC 86) involved a dispute between an investor and a company listed on the Catalist Board of the Singapore Exchange. The company went through a reverse takeover (RTO) before re-listing. However, the investor’s expectations of a handsome return on his pre-RTO investment did not eventually materialise after the re-listing. The investor then commenced an action against the company.

Central to the dispute was the consolidation of the company’s shares and subsequent issue price of the consolidated placement shares. Under a sale and purchase agreement between the investor and the company, the company had an obligation to use its best commercial endeavours to ensure that all its shares will be, when issued, duly listed and admitted for trading. The investor alleged that the agreement (expressly or impliedly) required the company to undertake best commercial endeavours to ensure that it would not unilaterally undermine its value (and hence the value of the investor’s shares) prior to the re-listing.

The court dismissed all of the investor’s claims. In reaching its decision, the court reaffirmed the objective approach to contractual interpretation and rejected the investor’s interpretation of the best endeavours clause. The court also declined to imply any term into the agreement, as there was no necessity to do so and the investor’s proposed term contradicted the express terms of the agreement.

The third case (AL Shams Global Ltd v. BNP Paribas [2018] SGHC 143) involved a customer’s claim against its bank for refusing to accept an incoming payment into its account.

In rejecting the customer’s claim, the High Court found that the contract between the parties conferred on the bank the discretion to decide whether to accept any incoming payment. In this regard, the bank was free to exercise its discretion provided that it did so in
good faith and not in an arbitrary, capricious or perverse manner. There was no evidence to suggest that the bank exercised its discretion in an arbitrary, capricious or perverse manner, or in bad faith.

The customer appealed against the High Court’s decision. His appeal was unanimously dismissed by the Court of Appeal in April 2019.

This case demonstrates that where a party is conferred an absolute discretion under the terms of the contract, the courts would have regard to the terms and require a high threshold before finding that the discretion has been exercised improperly.

### iii Trends

**MAS enforcement actions**

On 20 March 2019, the MAS published its enforcement report for the 18-month period ending December 2018. The report outlines the MAS’ enforcement actions, priorities, and statistics in a bid to provide greater accountability to the general public.

The report explains that from 1 July 2017 to 31 December 2018, the MAS has issued:

- **a** S$16.8 million in penalties to 42 financial institutions;
- **b** 37 reprimands to five individuals and 27 financial institutions;
- **c** 223 warnings to 32 individuals, 162 financial institutions, eight digital token exchanges, and one initial coin offering issuer;
- **d** 31 letters of advice to 29 individuals and two companies;
- **e** 19 prohibition orders banning unfit representatives from re-entering the financial industry; and
- **f** 444 supervisory reminders to 52 individuals and 317 financial institutions.

The average time taken for a regulatory action was six months, and 33 months for a criminal prosecution.

The report also sets out the MAS’ enforcement priorities for 2019 to 2020:

- **a** ensuring timely and adequate corporate disclosures;
- **b** overseeing the business conduct of financial advisers and their representatives;
- **c** tightening of internal controls of brokerage houses to stop market abuse;
- **d** anti-money laundering and countering of terrorist financing; and
- **e** insider trading.

The general trend over the past several years has been for the MAS to pursue enforcement proceedings under the civil penalty regime. This has resulted in greater efficiency in enforcement as there is greater incentive for a defendant to reach a settlement given the absence of any criminal sanctions and the possibility of settling the matter without admission of liability. In January 2020, in its first civil penalty enforcement action for failure to disclose shareholding interests, the MAS imposed a civil penalty of S$200,000 on an individual for not disclosing, and providing false information regarding his substantial shareholding in the company.
Claims against financial service providers

There have been no significant changes in the claims brought by or against financial service providers in the past year, although more matters are now resolved by way of ADR methods. For example, for the financial year ending 30 June 2019, FIDReC received 1,037 complaints. This was the second consecutive year in which FIDReC’s caseload has exceeded 1,000 cases, the majority of which were resolved at mediation.

VI OUTLOOK AND CONCLUSIONS

i Covid-19 pandemic

The covid-19 pandemic has caused significant disruptions to global financial markets and supply chains. Several countries have imposed lockdowns to contain the spread of the virus. With Singapore’s economy highly dependent on global trade, various sectors have already been hit hard even as the situation continues to develop. At the time of writing, the Singapore government has set aside close to S$60 billion (amounting to approximately 12 per cent of Singapore’s gross domestic product) to cushion the fallout. As the pandemic continues to unfold across the globe, it will not be unexpected if companies resort to corporate actions to keep businesses alive.

ii Penny stock crash

The 2013 penny stock crash is the biggest case of securities fraud in Singapore. The incident involved three entities – Blumont Group, LionGold and Asiasons Capital. These companies initially saw huge run-ups in their share prices. However, in October 2013, the companies’ shares crashed in a frenzied 40 minutes of trading and plunged further when trade resumed after a brief suspension. More than S$8 billion in shareholder value was lost in less than two days of trading.

It later transpired that three individuals had allegedly been involved in a scheme to manipulate the share prices of the companies. By controlling over 180 trading accounts and making thousands of manipulative trades, they created the illusion of liquidity and demand for the shares.

All three individuals have been charged with false trading and market rigging. One of the three individuals, Goh Hin Calm, has pleaded guilty and has been sentenced to three years’ imprisonment. The other two individuals have claimed trial, and criminal proceedings are currently ongoing.
Chapter 17

SOUTH KOREA

Tony Dongwook Kang

I  OVERVIEW

i  Sources of law

Primary source
The primary sources of securities law include the Financial Investment Services and Capital Markets Act (FSCMA), the Civil Act, the Commercial Act and the Criminal Act, all enacted by the National Assembly.

To cope with the complexity and fluidity of securities transactions, the Enforcement Decree of the FSCMA enacted by the President of Korea, and the Enforcement Rule of the FSCMA enacted by the Prime Minister of Korea (which stipulates detailed regulations for implementation of FSCMA), lay down material standards and requirements in relation to securities transactions.

Other regulations
Other regulations relevant to securities transactions include the Regulations on Financial Investment Business, the Regulations on Issuance, Public Disclosure, etc., of Securities and the Regulations on Return of Short-Swing Profit, Investigations and Report on Unfair Trades, etc., enacted by the Financial Services Commission (FSC), an entity established under the Act on the Establishment, etc., of the Financial Services Commission (AEFSC). Further, the Financial Supervisory Services (FSS) (which is established under the AEFSC as delegated under the FSCMA) has enacted detailed regulations on the above regulations, as delegated by relevant laws.

Judicial interpretations by the Supreme Court
Supreme Court precedents are not the primary source of securities law under the Korean legal system, where the principle of stare decisis is not recognised. However, as courts tend to follow Supreme Court precedents in securities-related litigation, such precedents are ‘de facto binding’.

ii  Regulatory authorities

Korean domestic regulatory authorities concerning securities transactions include the FSC, the Securities and Futures Commission (SFC) and FSS, all established under the AEFSC. The FSC is a central administrative agency under the Prime Minister, and has purview over

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matters concerning: financial policy and financial systems; and the management, supervision and surveillance of financial institutions and capital markets. The FSC has the authority to establish, amend and abrogate regulations related to the above matters, and if the FSS reports any violation committed by a financial institution to the FSC, sanctions may be imposed on the financial institution after the FSC examines the matter.2

The SFC is an internal committee within the FSC, and is responsible for: investigation of unfair trading (e.g., insider trading) in the capital markets; and affairs concerning accounting standards.3

The FSS conducts inspection and supervision of financial institutions, under the guidance and supervision of the FSC and the SFC.4 The FSS has primary supervisory authority over financial institutions in Korea.

### iii Common securities claims

**False statement**

If a person who acquires securities incurs damages because of a false description or representation of a material fact in a registration statement or an investment prospectus, or an omission of a description or representation of a material fact therein, then he or she may claim damages against the persons5 involved in the preparation of the registration statement and the investment prospectus within one year of the day on which he or she became aware of the fact, or within three years of a registration statement related to the relevant securities becoming effective.6

Pursuant to the FSCMA, a corporation listed on a stock exchange is required to submit its business report to the FSC and Korea Exchange (KRX) within 90 days of the end of each business year.7 If a person who acquires or disposes of securities incurs damages owing to a false description or representation of a material fact in such business report or an omission of a description or representation of a material fact therein, he or she may claim damages against the persons8 involved in the preparation of the business report, etc., within one year of the date on which he or she became aware of the fact, or within three years of the relevant submission date of the business report.9

However, the accused person is not liable if he or she proves that he or she was unable to know this fact and exercised reasonable care, or that the person who acquired the securities knew the fact at the time when he or she made an offer to acquire them.10

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2 Articles 3 and 17 of the AEFSC.
3 Article 19 of the AEFSC.
4 Articles 24 and 37 of the AEFSC.
5 This includes the issuer of the securities or directors of the issuer of the securities; a person who instructed or executed the preparation of the registration statement; a certified public accountant, etc., who has certified with his or her signature that the descriptions of the registration statement or the documents attached thereto are true and correct; an underwriter or intermediary of the securities; etc.
6 Articles 125 and 127 of the FSCMA.
7 Article 159 of the FSCMA.
8 This includes the corporation that submitted the business report and directors of the corporation, a person who gave direction on, or carried out, preparation of the business report, a certified public accountant who has certified with his or her signature that the descriptions of the business report, and the documents attached thereto, are true and correct.
9 Article 162 of the FSCMA.
10 Articles 125 and 162 of the FSCMA.
**Insider trading**

The FSCMA provides that if any insider\(^{11}\) who has the opportunity to use non-public information of a corporation listed in a stock exchange derives profit by purchasing securities issued by the corporation and then selling them within six months or by selling the securities and then repurchasing them within six months, the corporation may require the insider to return the short-swing profit to the corporation, regardless of whether or not the insider actually used the non-public information.\(^{12}\)

The FSCMA prohibits an insider\(^{13}\) who becomes aware of any material non-public information of a corporation listed on a stock exchange in the course of performance of the business, or a person who received the material non-public information from the insider, from using the material non-public information in trading or any other transaction involving specific securities or allowing another person to use such information.\(^{14}\) If the insider or the recipient of the information trades or makes any other transaction of specific securities in violation of the above provision, any person who has incurred damages because of the violation may claim damages against the offender within one year of the date on which the person becomes aware of the violation, or within three years of the date on which the violation was committed.\(^{15}\)

**Market manipulation**

The FSCMA prohibits manipulation of the market price of securities by (1) selling or purchasing securities at the value agreed to between a seller and a purchaser; (2) misleading a person to cause a misunderstanding that there is a significant trading of a security; (3) disseminating a rumour that fluctuations in the market price for securities are being caused by market manipulation; (4) making a false or misleading representation concerning a material fact in trading securities; (5) engaging in a series of purchases or sales in connection with listed securities or entrusting or being entrusted with this act, with an intention to fix or stabilise the market price of the listed securities; or (6) causing a fluctuation in, or fixing, the market price of underlying assets of certain derivatives with an intention to acquire unjust profits from trade of the derivatives.\(^{16}\)

Any person who incurs damages because of this market price manipulation may file a claim against the offender within one year of the date on which the person became aware of the market price manipulation or within three years of the date on which the act was committed.\(^{17}\)

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11 This includes officers, employees, or significant shareholders of the corporation.

12 Article 172 of the FSCMA.

13 This includes the company’s officer, employee or agent, significant shareholder, a person having authority to grant permission or authorisation, give instructions and supervise the corporation pursuant to applicable laws and regulations and a person who has entered into a contract with the corporation or is negotiating a contract with the corporation, and their agent or employee.

14 Article 174 of the FSCMA.

15 Article 175 of the FSCMA.

16 Article 176 of the FSCMA.

17 Article 177 of the FSCMA.
Unfair trading

The FSCMA generally prohibits unfair trading, such as: (1) utilising unfair means in connection with trading of securities; (2) making false descriptions or representations of a material fact; (3) utilising inaccurate market prices with the intent of attracting trading; (4) disseminating a rumour using a deceptive scheme or violence; and (5) making a threat with intent to cause fluctuation in the market price (Article 178 of the FSCMA). Any person who incurs damages because of this unfair trading may file a claim against the offender within one year of the date on which the person became aware of the unfair trading or within three years of the date on which the act was committed.18

On the other hand, owing to the speculative nature of short sales, the FSCMA allows short sales in exceptional cases,19 but only imposes an administrative fine for negligence for violation of this provision20 without any damages claims provisions, unlike for other unfair trading practices.

Accountants or auditor’s liability

The FSCMA provides that if there is a false description or representation of a material fact in a registration statement, an investment prospectus or a business report; or an omission of a description or representation of a material fact therein, a certified public accountant who has certified that the descriptions of the documents are true and correct is liable for damages inflicted upon any person who acquired securities.21

In addition, if an auditor has made a false description or representation of a material fact in an audit report attached to a business report, the auditor is liable for damages sustained by bona fide investors in reliance of the audit report.22

II PRIVATE ENFORCEMENT

Forms of action

General action

Any victim who incurs damages because of securities-related wrongdoings (false statement, insider trading, market manipulation and unfair trading) may file an action seeking damages in the form of individual actions or joint actions under the Civil Procedure Act (CPA). If the securities-related wrongdoings constitute torts under the Civil Act, the victim may elect to claim either damages under Article 750 of the Civil Act or damages under the FSCMA.

Class action

When at least 50 victims, who have common interests (who have legal or de facto material issues in common) and hold, in the aggregate, at least 1/10,000th of the total number of the outstanding securities of the defendant company, incur damages in the course of the trade or other transactions of securities because of false statements, insider trading, market

18 Article 179 of the FSCMA.
19 Article 180 of the FSCMA.
20 Article 449(1)39 of the FSCMA.
21 Articles 125 and 162 of the FSCMA.
22 Article 170 of the FSCMA. According to Article 170 of the FSCMA, liability arises pursuant to Article 17 of the Act on External Audit of Stock Companies, as opposed to Article 162 of the FSCMA.
manipulation, unfair trading or defective audits as set forth in the FSCMA, they may, after obtaining permission from a court, file a securities-related class action against the issuer of the securities to seek damages under Articles 125, 162, 170, 175, 177 and 179 of the FSCMA under the Securities-related Class Action Act (SCA).

**Derivative suits**

A shareholder of a corporation listed on a stock exchange (regardless of the number of shares held by the shareholder) may demand that the corporation file a claim against a person who derives a short-swing profit as set forth in Article 172(1) of the FSCMA for the return of such profit, and the shareholder may make the claim on behalf of the corporation, if the corporation does not file the claim within two months of receiving the demand.\(^{23}\)

If any director or auditor, or a person involved in the execution of duties of a company, engages in securities-related wrongdoings (false statement, insider trading, market manipulation or unfair trading) and, therefore, is liable for damages sustained by the company, any shareholder who holds no less than 1/100th (1/10,000th, in the case of a corporation listed in a stock exchange) of the total issued and outstanding shares may file an action on behalf of the company under the Commercial Act.\(^ {24}\)

**ii Procedure**

**General action**

If an action seeking damages is filed in relation to securities-related wrongdoings (false statement, insider trading, market manipulation or unfair trading), the procedures shall be in accordance with civil procedures under the CPA. Under the CPA, there is no discovery system as provided in Anglo-American law. However, it is possible to secure relevant documents from a defendant by obtaining a court’s order for submission of documents during the course of a trial.\(^ {25}\)

**Class action**

Securities-related class actions are under the exclusive jurisdiction of the collegiate panel of a district court that has jurisdiction over the location of a defendant’s general forum,\(^ {26}\) and unlike a general civil action, both plaintiff and defendant of a securities-related class action are required to appoint attorney-at-law as their counsel.\(^ {27}\) Further, the CPA applies *mutatis mutandis* to other matters related to a trial. Thus, as in the case of a general civil action, even though there is no discovery system, it is possible to secure relevant documents from a defendant by obtaining a court’s order for submission of documents during the course of a trial.\(^ {28}\)

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\(^{23}\) Article 172(2) of the FSCMA.

\(^{24}\) Article 403 of the Commercial Act.

\(^{25}\) Article 347 of the CPA.

\(^{26}\) Article 4 of the SCA.

\(^{27}\) Article 5 of the SCA.

\(^{28}\) Articles 6 and 32 of the SCA.
Derivative suits
If a shareholder of a corporation files an action seeking the return of a short-swing profit under the FSCMA on behalf of the corporation, there is no special restriction on jurisdiction or pleading methods. However, the shareholder, as a plaintiff, should remain as a shareholder of the corporation until the close of the action. With respect to other matters, general civil procedures apply.

iii Settlements

General action
In a general civil action, there is no restriction on settlement between parties or requirement for court approval of a settlement agreement.

Class action
In the case of securities-related class actions, the settlement of a lawsuit or waiver of claims shall be invalid without approval of a court, and where a court intends to determine whether to grant the settlement of a lawsuit or waiver of claims, the court shall give prior notice thereof to the class members and provide an opportunity to present opinions.29

Derivative suits
If a shareholder of a corporation files an action seeking the return of a short-swing profit under the FSCMA on behalf of the corporation, there is no restriction on settlement or requirement for court approval of a settlement agreement. However, if a shareholder of a corporation files an action on behalf of the corporation under the Commercial Act, no relevant party may waive claims or come to a settlement without permission from the court.30

iv Damages and remedies

False statement
The amount of damages for a false description or representation of any material fact in a registration statement or an investment prospectus31 or a business report32 is the amount estimated by subtracting either of the following amounts from the amount actually paid by the claimant for acquiring the securities at issue: the market price of the securities at the time of the last hearing of the lawsuit filed for the claim of damages (referring to an estimate disposal price if there is no market price available) or the disposal price if the securities are disposed of before the closing of the proceedings.33 However, the Supreme Court, in many instances, reduces the actual amount of damages by applying the legal principle of limitation on liability based on comparative negligence or the principle of fairness in determining the amount of damages.34

If the claimant claims damages under Article 750 of the Civil Act on grounds that a false description or representation of a material fact in a registration statement, investment

29 Article 35 of the SCA.
30 Article 403(6) of the Commercial Act.
31 Article 125 of the FSCMA.
32 Article 162 of the FSCMA.
33 Articles 126 and 162(3) of the FSCMA.
prospectus or a business report constitutes a tort, the amount of damages will be equal to the difference between the price the securities would have been without the false description or representation; and the price the securities were reduced to because of this false description or representation. The claimant will bear the burden of proof for the amount of damages.

**Insider trading**

The amount of a short-swing profit earned by an insider that is required to be returned\(^\text{35}\) shall be calculated based on the following formulas:

\[ a \]

where specific securities have been sold or purchased only once within six months of the purchase or sale in question being made, the profit is calculated by multiplying the difference between the unit selling price and the unit buying price by the smaller of the volume purchased and the volume sold (matching volume) and subtracting trading commission, securities transaction tax and special tax for rural areas applicable to the matching volume; and

\[ b \]

where specific securities have been sold or purchased twice or more within six months of the purchase or sale in question, the profit is calculated by applying the formula in (a) above to the portion purchased at the earliest point of time and the portion sold at the earliest point in time and applying the same formula to portions purchased and sold thereafter consecutively until the portions purchased or sold (to which the formula is applied) are completely exhausted.\(^\text{36}\)

There is no special provision within the FSCMA regarding the calculation method of damages caused by the use of material non-public information.\(^\text{37}\) Accordingly, under general Korean legal principles, the amount of damages will be equal to the difference between the stock price after the lapse of a certain period of time from the disclosure of the non-public information and the stock price at which an insider actually conducted the transaction. However, it has been pointed out that it is not easy for the claimant to prove the actual damage under such a formula. Thus, a new provision has been recently added to the CPA stipulating that ‘if the fact that damages incurred is acknowledged but it is very difficult to prove the specific amount of damages owing to the nature of the case concerned, a court may determine a reasonable amount of damages by taking into account the overall purpose of the pleadings and all relevant circumstances based on its examination of evidence’, and accordingly, the court may determine such amount of damages on an *ex officio* basis.\(^\text{38}\)

**Market manipulation**

There is no special provision within the FSCMA regarding the amount of damages for market price manipulation.\(^\text{39}\) However, in the *Hyundai Electronics* case, the Korean Supreme Court recognised ‘the difference between the price that would have been set if there had been no market price manipulation (normal stock price) and the price set as a result of the market price manipulation at which the victim actually conducted the transaction (manipulated stock price)’ as the amount of damages for the market price manipulation under general

\(^{35}\) Article 172 of the FSCMA.

\(^{36}\) Article 172(1) of the FSCMA, Article 195 (1) of the Enforcement Decree of the FSCMA.

\(^{37}\) Article 174 of the FSCMA.

\(^{38}\) Article 202-2 of the CPA.

\(^{39}\) Article 177 of the FSCMA.
Korean legal principles concerning the calculation of the amount of damages (the ‘difference theory’). However, the Korean Supreme Court, in many instances, reduces the actual amount of damages by applying the legal principle regarding limitation on liability based on comparative negligence or the principle of fairness in determining the amount of such damages.

**Unfair trading**

There is no special provision within the FSCMA regarding the amount of damages for unfair trading. As such, general Korean legal principles concerning the calculation of the amount of damages also apply to unfair trading cases, and the amount of damages will be equal to the difference between the price that would have been set if there had been no unfair trading and the price set as a result of unfair trading at which the victim actually conducted the transaction. Likewise, the actual amount of damages may be reduced based on comparative negligence or fairness principles.

### III PUBLIC ENFORCEMENT

#### i Forms of action

Under the FSCMA, the FSC is charged with supervising financial institutions to protect investors and maintain a sound system involving transactions. In practice, the FSS (not the FSC) supervises financial institutions under the guidance and supervision of the FSC. In particular, the FSC (or the SFC) may investigate or cause the FSS to investigate securities-related wrongdoings.

In addition, KRX established the Market Oversight Commission to conduct surveillance of the securities market, and when it becomes aware of securities-related violations, it is obligated to notify the FSC (or the SFC).

#### Administrative measures

If a financial institution engages in the use of material non-public information, market manipulation or unfair trading, the FSC may revoke the financial investment business licence or the financial investment business registration of the financial institution.

According to the FSCMA, securities-related false statements may result in an administrative fine not exceeding 3/100ths of the public offering or sale amount entered to the relevant registration statement (capped at 2 billion won if the amount exceeds 2 billion won). However, the FSCMA does not provide for monetary sanctions (e.g., fines) for negligence with respect to securities-related insider trading, market manipulation or unfair trading.

41 Korean Supreme Court judgment, 2013Da11621, 14 May 2015.
42 Article 178 of the FSCMA.
43 Articles 415 and 419 of the FSCMA, Articles 24, 37 and 38 of the AEFSC.
44 Article 426 of the FSCMA.
45 Articles 402 and 426(6) of the FSCMA.
46 Article 420 (1) of the FSCMA, Article 373 (1) of the Enforcement Decree of the FSCMA.
47 Article 429 of the FSCMA.
trading (activities set forth in Articles 172, 174, 177 and 178 of the FSCMA). On the other hand, the FSCMA provides that unfair trading by use of material non-public information may be subject to an administrative fine not exceeding 500 million won.

Criminal penalties
A person who uses material non-public information, engages in market manipulation, disseminates a rumour, uses a deceptive scheme or coerces someone by violence or threat with intent to fluctuate the market price may be criminally punished. Further, if a representative of a corporation or its agent, employee or any other employed by a corporation is criminally punished pursuant to the provision above, such corporation may also be fined, unless the corporation proves that it has paid due attention to or diligently supervised the relevant business to prevent such violation.

ii Procedure

Investigation
In general, the FSS investigates any violation of the FSCMA under the guidance and supervision of the FSC, whereas the SFC is responsible for the investigation of securities-related violations (false statement, insider trading, market manipulation or unfair trading, i.e., activities set forth in Articles 172, 174, 177, 178 and 426 of the FSCMA).

The SFC may, if deemed necessary when conducting the investigation, make a demand on a financial institution to submit statements and other documents and evidence, and may, if deemed necessary, seize evidence or search offices. Details on procedures involving such investigations are set forth in the Regulations on Return of Short-Swing Profit, Investigations and Report on Unfair Trades, etc.

FSC resolutions and sanctions
Matters relating to FSC deliberations, resolutions and sanctions regarding FSCMA violation are set forth in the Regulation on Investigation of Capital Markets (RICM). The RICM provides that the FSC (or the SFC) may, after review on findings of an investigation of securities-related violations by the capital market investigation and deliberation committee, elect to (1) file a report or send a notice to an investigation agency (e.g., the Prosecutor’s Office) concerning the violation; (2) issue a corrective order; or (3) issue a warning. In addition, when the SFC discovers an accrual of short-swing profits of an insider as a result of the investigation, it is required to notify the relevant corporation.

If the FSC (or the SFC) intends to issue any of the sanctions above, it must give 10 days’ prior notice to the subject person, and that person may submit an opinion to the FSC (or the SFC). In sum, the FSC (or the SFC) may only take the above measures after duly completing relevant procedures.

48 Article 178-2 of the FSCMA.
49 Article 429-2 of the FSCMA.
50 Article 443 of the FSCMA.
51 Article 448 of the FSCMA.
52 Articles 426(3), (4), and 427 of the FSCMA.
53 Articles 21, 24–29 of the RICM.
54 Article 172(3) of the FSCMA, Article 28 of the RICM.
55 Articles 36, 37 of the RICM.
If the subject person has any objection to the sanctions issued by the FSC (or SFC), he or she may file an objection within 30 days of the date of the notice, and if the sanction is eligible to become a subject matter of an administrative litigation as an exercise of administrative authority, the subject person may file administrative litigation within 90 days of the date on which he or she becomes aware of the relevant measures.\textsuperscript{56}

\textbf{Criminal proceedings}

If the SFC files a report or issues a notice of securities-related violations to an investigation agency (i.e., the Prosecutor’s Office), the agency will proceed with an investigation and may file an indictment against the offender. The offender may be criminally punished after a criminal trial.

\textbf{iii  Settlements}

In principle, under Korean law, no settlement, mediation or plea bargaining is allowed for administrative measures and criminal punishment for securities-related violations. However, if administrative litigation is filed with respect to the FSC sanctions, these sanctions may be subject to change by way of mediation or settlement during the course of litigation. In addition, the Prosecutor’s Office or the court may apply a lighter sentence to any offender who cooperates during the investigation.

\textbf{iv  Sentencing and liability}

\textit{Administrative sanctions}

With respect to securities-related violations (false statement, insider trading, market manipulation or unfair trading, i.e., activities set forth in Articles 172, 174, 177, and 178 of the FSCMA), if the offender is a financial investment firm, the FSC (or the SFC) may:

\begin{itemize}
  \item[a] revoke the financial investment business licence or the financial investment business registration;
  \item[b] suspend its business entirely or partially for no more than six months;
  \item[c] order it to transfer certain contracts to third parties;
  \item[d] order it to correct or discontinue violation;
  \item[e] order it to publicly disclose or notify of the fact that it is subject to certain sanctions because of its violation;
  \item[f] issue a warning; or
  \item[g] issue a reprimand.\textsuperscript{57}
\end{itemize}

\textit{Criminal punishment}

Criminal punishment for securities-related wrongdoings are as follows under Article 443 of the FSCMA.
Criminal liabilities

<table>
<thead>
<tr>
<th></th>
<th>Base level punishment</th>
<th>If the profit is 500 million won or more, but less than 5 billion won</th>
<th>If the profit is 5 billion won or more</th>
</tr>
</thead>
<tbody>
<tr>
<td>Using material non-public information</td>
<td>Imprisonment for up to 10 years or a fine equivalent to one to three times the profit accrued or the loss avoided by a violation; suspension of qualification for not more than 10 years may be imposed concurrently.</td>
<td>Punishment shall be aggravated to imprisonment for no less than three years.</td>
<td>Punishment shall be aggravated to imprisonment for life or for no less than five years.</td>
</tr>
<tr>
<td>Market manipulation</td>
<td>Disseminating a rumour, using a deceptive scheme, violence a threat, with an intention to attempt to fluctuate the market price</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Under the vicarious liability provisions, a corporation may also be subject to a fine equivalent to one to three times the profit accrued or the loss avoided by a violation.58

IV CROSS-BORDER ISSUES

i Private actions

Under the FSCMA, any activities conducted in a foreign country the effects of which extend to the territory of Korea shall be governed by the FSCMA,59 thereby introducing the ‘effects doctrine’ regarding the extraterritorial application under US securities law. Accordingly, theoretically, if securities-related violations were committed abroad in relation to overseas securities issued in a foreign country, and it had a foreseeable and material adverse effect on Korean domestic investors or markets, Korean civil courts will have jurisdiction over a claim for damages filed by the investors.

However, if the issuer of overseas securities is engaged in market price manipulation60 or unfair trading61 in connection with exchange-traded derivatives, and such activities have an adverse effect on Korean domestic investors or markets, it is debatable whether Korean civil courts have jurisdiction over a claim for damages against the issuer of the overseas securities.

ii Public enforcement

Theoretically, Korean domestic regulatory authorities, such as the FSC, could have the authority to conduct an investigation into and take administrative measures against securities-related violations committed by the issuer of overseas securities. However, in practice, it appears that Korean domestic regulatory authorities have never conducted any investigation into or taken any administrative measures against securities-related violations committed abroad by the issuer of overseas securities.

Further, in principle, the Korean Criminal Act applies to both Korean nationals and aliens who commit crimes within the territory of Korea (i.e., the territorial principle), and exceptionally applies to all Korean nationals who commit crimes outside the territory of Korea (i.e., the personal principle).62 Thus, securities-related violations committed by the issuer of overseas securities in Korea or securities-related violations committed by Korean nationals may be criminally punished.
V YEAR IN REVIEW

i Leading cases
A leading case concerned certain equity-linked security (ELS), which was designed in such a way that if the closing prices of both underlying assets (i.e., common shares of Kookmin Bank and common shares of Samsung Electronics on the base date of 26 August 2009) are not less than 75 per cent of the initial base price, the principal amount and a 28.6 per cent return on investment was to be paid to investors (paid at maturity), but if the closing price of any of the underlying assets is less than 75 per cent of the initial base price, then investors were to bear the risk of losing the principal.

On the base date of 26 August 2009, the defendant Deutsche Bank intentionally sold common shares of Kookmin Bank so that the condition for payment of returns at maturity could not be fulfilled.

On 24 March 2016, the Korean Supreme Court held that Deutsche Bank’s sale of the shares constituted market manipulation or unfair trading intended to lower the closing prices of the above shares as of the base date and was intended to prevent the fulfilment of the condition, and further held that Deutsche Bank was liable for damages sustained by the investors who invested in the ELS.63

On 2 March 2012, the investors to the ELS discussed above filed a securities-related class action against Deutsche Bank under the SCA, and on 27 May 2016, the Korean Supreme Court granted permission for the securities-related class action,64 and the Seoul Central District Court rendered a judgment in favour of the investors on 20 January 2017.65 This case is significant in that it is the first judgment on securities-related class action following the introduction of the securities-related class action system in Korea in 2005.

In the case reversed and remanded, Deutsche Bank was held liable for damages and judgment was rendered in favour of the investors. However, Deutsche Bank filed an appeal and the trial is currently pending before the Korean Supreme Court (Korea Supreme Court Case No. 2016Da54612).

ii Overview of securities-related violations
The number of cases of securities-related violations (false statement, insider trading, market manipulation or unfair trading) reported between 2014 and 2016 as announced by KRX’s Market Oversight Commission is set out in the table below.

<table>
<thead>
<tr>
<th>Type of allegation</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of cases</td>
<td>Ratio (per cent)</td>
<td>No. of cases</td>
</tr>
<tr>
<td>Unfair trading</td>
<td>12</td>
<td>9.1</td>
<td>10</td>
</tr>
<tr>
<td>Market manipulation</td>
<td>54</td>
<td>40.9</td>
<td>52</td>
</tr>
<tr>
<td>Using non-public information</td>
<td>50</td>
<td>37.9</td>
<td>48</td>
</tr>
<tr>
<td>False statement</td>
<td>14</td>
<td>10.6</td>
<td>16</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>1.5</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>132</td>
<td>100</td>
<td>130</td>
</tr>
</tbody>
</table>
According to the above table, the number of cases of securities-related wrongdoings increased in 2016 compared to 2014 and 2015, and the ratio of cases of using non-public information increased.

VI OUTLOOK AND CONCLUSIONS

As the number of cases involving securities-related violations (false statement, insider trading, market manipulation or unfair trading) have been increasing as shown above, it is expected that the number of securities litigations will also increase in the future. In particular, there have been a number of securities-related class action filings in recent years (i.e., one case for each year from 2009 to 2012, two cases in 2013 and 2014, respectively, and one case in 2016).

<table>
<thead>
<tr>
<th>Plaintiff (representative plaintiff)</th>
<th>Defendant</th>
<th>Description</th>
<th>Filing date</th>
<th>Date of grant of permission for action</th>
<th>Progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yun-Bae Park and 1 other</td>
<td>Jinsung TEC and two others</td>
<td>Action involving Jinsung TEC’s accounting fraud related to KIKO</td>
<td>29 April 2009</td>
<td>January 2010</td>
<td>Settled (April 2010)</td>
</tr>
<tr>
<td>Il-Nam Yang and 1 other</td>
<td>Royal Bank of Canada</td>
<td>Action involving ELS hedge manager’s yield manipulation</td>
<td>31 December 2010</td>
<td>March 2016</td>
<td>Settlement pending</td>
</tr>
<tr>
<td>Jae-Hyung Lee and 185 others</td>
<td>Dongbu Securities and one other</td>
<td>Action involving a false statement in a registration statement of C-motech against relevant arranger and securities company</td>
<td>22 October 2011</td>
<td>May 2016</td>
<td>Litigation on the merits pending</td>
</tr>
<tr>
<td>Soon-Deok Kim and 5 others</td>
<td>Deutsche Bank</td>
<td>Action involving ELS hedge manager’s yield manipulation</td>
<td>9 March 2012</td>
<td>May 2016</td>
<td>Plaintiff won the first trial (20 January 2017)</td>
</tr>
<tr>
<td>Tae-Eung Kim and 14 others</td>
<td>GS E&amp;C</td>
<td>Action involving an omission in a registration statement of GS E&amp;C</td>
<td>16 October 2013</td>
<td>November 2016</td>
<td>Litigation on the merits pending</td>
</tr>
<tr>
<td>Ji-Woon Kim</td>
<td>GeneMatrix and two others</td>
<td>Action involving manipulation of price of stock of GeneMatrix</td>
<td>2 December 2013</td>
<td></td>
<td>Waiting for permission</td>
</tr>
<tr>
<td>Won-II Suh and 1253 others</td>
<td>Tong Yang Securities and 20 others</td>
<td>Action involving accounting fraud of Tongyang Inc.</td>
<td>20 June 2014</td>
<td></td>
<td>Waiting for permission</td>
</tr>
<tr>
<td>Jong-Ku Kang and 19 others</td>
<td>Tong Yang Securities and 10 others</td>
<td>Action involving fraudulent issuance of CP by an affiliate of Tong Yang Group</td>
<td>July 2014</td>
<td></td>
<td>Waiting for permission</td>
</tr>
<tr>
<td>Jun-Shik Lee</td>
<td>Samil PricewaterhouseCoopers</td>
<td>Action involving an accounting firm’s poor auditing of Tongyang Networks</td>
<td>28 January 2016</td>
<td></td>
<td>Waiting for permission</td>
</tr>
</tbody>
</table>
In particular, as discussed above, the class action filed in relation to Deutsche Bank’s market price manipulation is particularly significant in that a judgment was rendered in favour of investors for the first time in the history of securities-related class action under the SCA.

Furthermore, securities-related class actions were filed in relation to a false statement or an omission in registration statements prepared by C-motech and GS E&C, respectively, and deliberation on the merits is pending following a grant of permission from the relevant court.

However, securities-related class actions under the SCA currently in effect generally take 51.5 months on average to obtain a court’s permission. In that regard, some commentators point out that this is an efficient means to remedy damage sustained by investors. In addition, as the system of discovery under the Anglo-American law is not recognised in a Korean securities-related class action, investors generally face difficulty in proving relevant facts. In this respect, there is a view that the SCA should be amended to remedy such defects.
I  OVERVIEW

i  Sources of law

The Swedish legal framework governing securities has undergone major changes since the beginning of the twenty-first century as a result of increasingly extensive and detailed EU legislation. The current legislation in the field of securities law is largely based on EU legislation, the most important being:

a. the Markets in Financial Instruments Directive (2004/39/EC) (MiFID I);
b. its successors MiFID II and MiFIR; and
c. Regulation (EU) No. 596/2014 (the Market Abuse Regulation (MAR)).

EU directives are implemented in Sweden via acts passed by parliament. The EU legal element means that courts, authorities and other practitioners and users must always interpret national laws and regulations implementing the directive in conformity with EU law and principles. EU regulations, on the other hand, are directly binding and applicable once they have been adopted by the European Parliament and the European Council. EU regulations therefore apply in the same manner as acts passed by the Swedish parliament.

The principal pieces of legislation in the field of securities law are:

a. the Securities Market Act (2007:528);
b. the Financial Instruments Trading Act (1991:980);
c. the Notification Requirement Act (2000:1087);
d. the Act on Public Takeover Offers (2006:451);
e. the Market Abuse Act (2016:1307);
f. the Act Complementing the EU’s Market Abuse Regulation (2016:1306);
g. the SFSA Regulations; and
h. the rules of the relevant stock exchange (e.g., the Rulebook for Issuers and the Takeover Rules published by Nasdaq OMX Stockholm Stock Exchange).

There are also several statutes potentially relevant in the context of securities litigation that do not deal specifically with securities. These include, inter alia:

1. David Ackebo is a partner and Andreas Johard is a managing associate at Hannes Snellman Attorneys Ltd.
3. All as amended from time to time to ensure consistency with EU requirements.
Sweden

\(a\) the Companies Act (2005:551);
\(b\) the Code of Judicial Procedure (1942:740); and
\(c\) various items of consumer protection legislation.

ii Regulatory authorities

Regulatory authority – the SFSA

The Swedish Financial Supervisory Authority (SFSA)\(^4\) is the central competent regulatory authority responsible for the supervision, regulation and authorisation of financial markets and their participants. The SFSA has a comprehensive range of supervisory and administrative enforcement powers. It is also authorised to issue regulations and guidelines to supplement the fundamental provisions set out in the parliamentary acts.

Self-regulatory bodies

The Nasdaq OMX Stockholm Exchange

Sweden has two stock exchanges. The largest and by far the most dominant exchange is the Nasdaq OMX Stockholm Exchange (NSE). Although the SFSA has been given a more active supervisory role during the past few years with regard to the supervision of listed companies,\(^5\) self-regulation is still an essential and distinctive feature of the Swedish securities market. In particular, the role of the NSE remains significant. According to the Securities Market Act (SMA), a stock exchange shall have clear and transparent rules for the admission to trading of financial instruments on a regulated market.\(^6\) The SMA also stipulates that a stock exchange must have rules regarding takeover bids for shares admitted to trading on a regulated market operated by the relevant stock exchange.\(^7\) The listing and takeover rules of the NSE indirectly implement several EU Acts, and the NSE is responsible for monitoring compliance with its rules.

The Swedish Securities Council

Another self-regulatory body is the Swedish Securities Council (SSC), which is essentially the equivalent of the Takeover Panel in the United Kingdom, but with a much larger scope. Its mission is to promote good practices on the Swedish market in any relevant aspect, including in relation to public takeovers. The SFSA has delegated certain duties under the Act on Public Takeover Offers to the SSC. Additionally, the NSE has delegated to the SSC the right to decide on exemptions from the provisions in the NSE’s takeover rules and how these rules are to be interpreted.

Judicial authorities

The district courts (courts of first instance)

There are no specialist courts or specialist judges for securities litigation. Rather, the Swedish district courts have jurisdiction to handle both civil and criminal actions relating to improper securities activities.

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\(^4\) Sw. Finansinspektionen.
\(^5\) Especially as a result of the Market Abuse Regulation.
\(^6\) Chapter 15, Section 1 of the Securities Market Act.
\(^7\) Chapter 13, Section 8 of the Securities Market Act.
The administrative courts

As in several other European countries, Sweden has a judicial system with administrative courts that deal with cases relating to various types of disputes between primarily private persons and authorities. For most of the administrative sanctions imposed by the SFSA, appeals are heard before the administrative courts.

The Swedish National Economic Crimes Authority

The Swedish National Economic Crimes Authority (SNECA) is the relevant prosecutorial body in relation to criminal enforcement of securities laws. It is a specialist authority within the public prosecution service and handles all sorts of economic crimes, including insider trading, market abuse and market manipulation.

iii Common securities claims

Insider dealing and market manipulation

Rules relating to prohibitions on insider trading, unlawful disclosure of insider information and market manipulation are set out in the Market Abuse Act.8

Insider information is defined as information of a precise nature that has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.9

The Market Abuse Act prohibits any person who has obtained insider information from acquiring or disposing of the financial instruments to which the information relates, and from advising or in any other manner causing any third party to acquire or dispose of those financial instruments.10

The Market Abuse Act also prohibits any person from disclosing information that constitutes insider information, unless the disclosure occurs in the normal course of the exercise of a person's employment, profession or duties, or where the information is placed into the public domain simultaneously with its disclosure.11

Furthermore, the Market Abuse Act prohibits any person, in conjunction with trading on the securities market or otherwise, from acting in a manner that gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of financial instruments.12

Insider trading and market manipulation are both offences that are often difficult to investigate, partly because they are usually committed by persons who are much more familiar with securities and trading than the prosecutors and, particularly, the members of the

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8 Whereas the Market Abuse Act regulates criminal enforcement proceedings relating to market abuse, MAR and the Act Complementing MAR (2016:1306) regulate administrative enforcement proceedings of market abuse.
9 MAR Article 7.1.a. Information shall be deemed to be of a 'precise nature' if it indicates a set of circumstances that exists or that may reasonably be expected to come into existence, or an event that has occurred or that may reasonably be expected to occur, where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the financial instruments or the related derivative financial instrument (Article 7.2).
10 Chapter 2, Section 1 of the Market Abuse Act.
11 Chapter 2, Section 3 of the Market Abuse Act.
12 Chapter 2, Section 4 of the Market Abuse Act.
Statistics from the past four years reveal that, on average, approximately 200 suspected insider trading cases and 150 suspected market manipulation cases per year are investigated by the SFSA, and nearly all of them are reported to the SNECA. However, few cases lead to prosecution and even fewer lead to convictions.

MAR entered into effect on 3 July 2016, thereby repealing the Market Abuse Directive in its entirety. This reflects one of the most significant changes in the field of securities law in Sweden in the past years. To begin with, MAR is an EU Regulation and not a Directive. This means that its provisions are directly applicable and binding. Furthermore, MAR imposes new requirements on listed issuers and introduces more comprehensive procedural powers for the competent national authorities (in Sweden the SFSA). MAR is also broader in scope compared with its predecessor, encompassing a wider range of financial instruments and trading facilities.

Some of the key changes for listed issuers include:

a. more extensive and detailed record-keeping obligations in relation to insider lists;

b. amendments to the regime for the approval and reporting of transactions committed by persons discharging managerial responsibilities; and

c. introduction of stringent procedures to follow when conducting market soundings.

To ensure compliance with the new requirements under MAR, issuers are advised to update several of their internal policies, guidelines and procedures.

The SFSA may impose administrative sanctions under a variety of rules, including under MAR in cases of, for example, market abuse, and the NSE may sanction breaches of its listing and takeover rules (see Section III).

A listed issuer is under a continuous disclosure obligation to disclose inside information in accordance with Article 17 of MAR (delayed disclosure is only permitted in certain circumstances). In addition, there are a number of disclosure rules relating to public takeovers (e.g., rules governing prospectuses). There is also a general requirement that all disclosed information shall be fair, clear and not misleading. Common administrative actions include supervision and enforcement of the disclosure rules.

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13 The number is rising each year, see www.fi.se/sv/publicerat/statistik/marknadsmissbruk.
14 Although in no need of Swedish legislation, the Swedish parliament has revised a number of statutes in the field of securities law and enacted the Act Complementing the EU’s Market Abuse Regulation (2016:1306) to ensure consistency with MAR.
15 A person discharging managerial responsibilities means a person within an issuer, an emission allowance market participant or another entity referred to in MAR Article 19(10), who is: (1) a member of the administrative, management or supervisory body of that entity; or (2) a senior executive who is not a member of the bodies referred to in point (1), who has regular access to inside information relating directly or indirectly to that entity and power to take managerial decisions affecting the future developments and business prospects of that entity (MAR Article 3.1.25).
16 Market soundings are interactions between a seller of financial instruments and one or more potential investors, prior to the announcement of a transaction, to gauge the interest of potential investors in a possible transaction and its pricing, size and structuring. Market soundings could involve an initial or secondary offer of relevant securities, and are distinct from ordinary trading (MAR Article 11).
17 It also bears mentioning that the changes listed above only reflect a minor selection of the new requirements imposed on issuers under MAR.
II PRIVATE ENFORCEMENT

The majority of enforcement actions in Sweden are public enforcement actions. Private securities litigation is unusual. This is probably partly because of the fact that Swedish law, in general, lacks statutory rules regulating civil liability in relation to improper securities activities, and partly because Sweden does not have a cultural tradition of tort litigation. A third reason might be that the majority of the investors acquire financial instruments through financial intermediaries. Therefore, the most natural claim for damages would be against an agent or a financial adviser.

There are explicit civil liability provisions for founders, board members, managing directors, auditors, general examiners and special examiners in a company that has prepared and issued a prospectus. According to the Swedish Companies Act, each of these bodies shall compensate anyone who suffers a loss caused by a breach of the provisions in Chapter 2 of the Financial Instruments Trading Act (1991) or the Commission Regulation (EC) No. 809/2004 of 29 April 2004 implementing Directive 2003/71/EC regarding information contained in prospectuses. The same applies where damage is caused to a shareholder or other person because of a breach of the applicable annual accounts legislation. Apart from this, Swedish law does not contain any specific provisions as regards which parties can be held liable for false or misleading information, whether in a prospectus or otherwise. Private litigation is rare, and case law on the matter is very scarce. The main rule under Swedish law is that, in the absence of a contractual relation or explicit statutory provisions, liability requires that the damage has been caused by a criminal offence. The exceptions to the main rule are to be developed by case law, and the Swedish Supreme Court has on several occasions made exceptions to this rule. It remains to be seen what exceptions (if any) can be made in relation to false or misleading information in the field of securities law.

The special provisions set forth in the Swedish Companies Act on the liability towards shareholders and other investors for breaches of the applicable annual accounts legislation were subject to a landmark judgment in 2014 (the BDO case). The case concerns an auditor’s (BDO’s) liability for false and misleading information contained in an annual report. However, it has with good reason been argued that the ruling contains important statements of general application, and thus being of importance for, for example, the scope of board members’ liability under the Swedish Companies Act. In its judgment, the Supreme Court introduced a new requisite of ‘justifiable reliance’ in relation to the false or misleading information that an investor must demonstrate in order to obtain damages. Only reliance of a certain strength and relevance qualifies and reaches this high threshold. The Supreme Court explained that a business decision should be deemed to be based on a justifiable reliance on

18 Chapter 29, Section 1, Paragraph 2 of the Companies Act.
19 It remains uncertain whether the issuer itself can be held liable to pay damages for false or misleading statements made by its representatives under Swedish law. According to the predominant view, the answer is negative; see C Af Sanberg et al., Law of Exchange (2011), p. 237 et seq.
20 The acquisition of shares made in connection with an issue is not considered as a ‘purchase’, as this notion is otherwise understood in the law of obligations under Swedish law. Therefore, the rules regarding, for example, sale of goods are not considered applicable to such acquisitions.
22 See further D Sveen and J Anderson, The protection for investors following the BDO-case, Juridisk Tidsskrift No. 12017/18 p. 233 et seq. As noted above, the board, the CEO and the auditor share joint and several liability for breaches of the applicable annual accounts legislation.
information in a certain annual report if the decision ‘concerns a business relation with the company or a transaction in respect of shares or other instruments issued by the company’. In other words, it appears that investors who purchase shares on the secondary market will most likely fail to establish justifiable reliance. The group of investors entitled to compensation thus seems to have been significantly narrowed, and the judgment has been criticised for weakening investor protection.23

i  Forms of action

A person suffering damage because of improper securities activities cannot turn to the SFSA for damages. The only alternative to claim damages is to file a claim against the damaging party with the civil courts. In cases of insider trading or market abuse, an aggrieved party may also intervene in a criminal proceeding and seek damages in the trial.24 Under Swedish law, whoever causes damage to another person by way of a criminal act is liable to that person for damages.

Although civil liability for losses resulting from false or misleading statements or any other improper security activity can exist under Swedish law, such claims are, as mentioned, rare.25

ii  Procedure

The Code of Judicial Procedure (CJP) governs all aspects of the conduct of civil court claims, and, thus, also private securities claims.

Judicial proceedings commence by the claimant submitting a written summons application (statement of claim) to the district court, which must comply with certain requirements provided by the CJP.

More specifically, the summons application shall include:

a  a distinct relief sought;
b  a detailed account of the circumstances invoked as the basis for the claim;
c  primary statement of the evidence relied upon; and
d  the circumstances rendering the court competent, unless this is apparent from what is otherwise stated.26

23  ibid.
24  This requires that a party is considered as the ‘aggrieved party’ as this concept is defined in the field of criminal law. The criminal definition of the concept of aggrieved party is set forth in Chapter 20, Section 8, Paragraph 4 of the CJP; according to which the aggrieved person is the person against whom the offence was committed or who was affronted or harmed by it. It is unclear whether a person suffering damage because of insider trading or market abuse falls within the scope of this definition. No relevant case law seems to exist.
25  Although not always relating to securities, it might be mentioned that litigation against negligent auditors has increased in Sweden in recent years. One example is the much-publicised judgment in the Prosolvia case (Case No. T 4207-10). In that case, civil liability proceedings were initiated by the bankruptcy estate of Prosolvia against PwC. The Court of Appeal found that PwC had failed to perform its audit in accordance with the relevant law and audit standards and that PwC therefore was liable to pay 2.1 billion kronor in damages for negligent auditing. Another example is the BDO case mentioned above.
26  Chapter 42, Section 2 of the CJP. The competent court for civil cases in general is the court of the place where the respondent resides (Chapter 10, Section 1 of the CJP) (see also Section IV).
Upon receipt of the summons application, the court issues a summons requiring the respondent to respond to the claim within the time limit set by the court. The answer shall state to what extent the claimant’s claims are admitted or contested, including therefore the respondent’s position as to the basis of the claims and also the basis for the defence. The claimant is typically ordered to submit a reply to the statement of defence. There is no limit to the number of submissions that each party may submit, unless the court decides otherwise.

A key feature of litigation in Sweden as regards evidence is the concept of ‘free evaluation of evidence’, which means that there is no admissible or non-admissible evidence. Instead, it is up to the court to consider and evaluate all evidence provided by the parties and to assign appropriate weight to each item of evidence. Only in exceptional circumstances, if the court finds certain evidence to be clearly superfluous, may the court dismiss evidence. There is no pretrial discovery in Swedish litigation. However, parties (and third parties) can be ordered by the court to produce documents upon the request of a party. Pursuant to Chapter 38, Section 2 of the CJP, anybody holding a written document that can be assumed to be of importance as evidence may be ordered to produce it. A prerequisite for the court to order a party (or third party) to produce documents is that the party seeking production must be able to sufficiently identify the documents to be produced and explain why the documents can be assumed to be of importance as evidence in the specific case. The level of precision is hard to define generally. To the extent that a document cannot be specified exactly, it may be sufficient that the requesting party identifies a certain defined category of documents, provided that what the party intends to prove with the documents is clearly specified.

Normally the court requests the parties to appear at a pretrial hearing, the purpose of which is to clarify the parties’ claims and positions, and which parts of the claim are admitted or denied by the respondent. It is normally sufficient that parties are represented by counsel at the pretrial hearing, but many judges encourage the parties also to have competent party representatives attending the pretrial hearing. The court is also under a duty to investigate whether there are possibilities for an out-of-court settlement during the pretrial hearing.

The practice of the courts is also to schedule, in consultation with the parties, the dates for the main hearing at the pretrial hearing. The main hearing begins with the claimant stating the relief sought and the respondent stating whether the claimant’s claims are contested or admitted. Thereafter, the parties, each in turn, shall present their cases and any written evidence. After that, any witnesses or experts are examined. Lastly, the parties present their closing arguments.

Litigation costs (for example, the cost for legal counsel) are assessed by the court at the end of the trial. The general rule is that the costs follow the events (i.e., the losing party reimburses the prevailing party for its costs). However, only costs that the court deems have

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27 Depending on the size and complexity of the claim, the time limit may vary from two to five weeks. If the respondent fails to submit a statement of defence within the applicable time limit, the claimant is able to apply to the court for a default judgment (Chapter 44 of the CJP).
28 Naturally, there are exceptions to the rule relating to, for example, certain mandatory rules on confidentiality.
30 Chapter 42, Section 6 of the CJP.
31 ibid.
32 Chapter 43, Section 7 of the CJP.
33 Chapter 18, Section 1 of the CJP.
been reasonably incurred to safeguard the prevailing party’s interest must be reimbursed. This means that if the losing party contests the winning party’s claim for costs, the court will determine whether the prevailing party’s costs are reasonable.

Rules governing lawyers’ fees are set forth in the Code of Professional Conduct issued by the Swedish Bar Association, according to which all fees charged by a lawyer must be reasonable, having regard to what has been agreed with the client and the extent of the mandate, its nature, complexity and importance, as well as the lawyer’s expertise, the result of the work and other such circumstances. Contingency fees are generally considered to be unethical and, therefore, prohibited. That being said, there is no restriction against setting the fees in relation to the outcome and degree of success as long as the fees do not compose a percentage or stake of the damages or other monetary relief.

Furthermore, there is no general restriction against third-party litigation funding, but such arrangements are unusual in Sweden, although they are becoming more common.

The judgment of a district court in a civil action can be appealed to the Court of Appeal. Leave to appeal is required for the Court of Appeal to review the district court’s judgment. Leave to appeal may be granted if it is of importance for the guidance of the application of law that the Court of Appeal tries the case or if there is reason to believe that the Court of Appeal would come to a different conclusion from that of the district court. Accordingly, leave to appeal may be granted on issues of facts. The threshold for leave to appeal to the Court of Appeal is relatively low. However, leave to appeal to the Supreme Court is much more restricted and is granted only in those cases where it is important to establish a precedent that may provide guidance for the Swedish district courts and courts of appeal. In other words, the Court of Appeal is in practice the final instance for most cases.

### iii Group litigation

The Group Proceedings Act (2002:559) (GPA) provides the possibility of binding together a plurality of claims against the same respondent into one group action (or class act), if the following criteria are met:

- the action falls within the scope of the competence of general courts under the CJP;
- the action is based on circumstances that are common or similar to the claims of the members or the group;
- a group proceeding does not appear to be inappropriate having regard to the claims of the group members;
- most of the claims to which the action relates cannot be equally and adequately pursued through personal actions by the individual members of the group;
- the group is appropriately defined, taking into consideration its size, scope and other factors; and
- the claimant can appropriately represent the members of the group, having regard to its interest in the substantive matter, its financial capacity to bring a group action, and the general circumstances of the case.

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34 Sw. Advokat.
35 Sections 4.1.1 and 4.1.2 of the Code.
36 Section 4.2.1 of the Code.
37 Chapter 49, Section 14 of the CJP.
38 There are no limits, neither maximum nor minimum, as regards the number of possible class members.
Claims for damages resulting from improper securities activities fulfil the first criterion and are, as such, permitted under the GPA.

The GPA has not yet been used to a great extent, and as far as we know it has never been used in connection with any securities litigation.

iv Settlements

Civil actions litigated in district courts may be settled at any time, within or outside the proceedings, by way of a settlement agreement. The claimant may, at any time, withdraw its claim. However, should the claimant withdraw its claim after the respondent has submitted its reply, the case shall nonetheless be adjudicated upon if the respondent so requests.

If the parties agree on a settlement of the dispute, they are free to decide whether the settlement shall be confirmed by the court by way of a consent judgment. If confirmed, the settlement (i.e., the judgment) will become enforceable and have res judicata effect. The court does not assess the fairness or reasonableness of the conditions of the settlement, but it may refuse to confirm a settlement that violates public policy, or that is too difficult to enforce (e.g., if the settlement includes too many uncertain elements and subjective conditions). If not confirmed, the settlement agreement will be subject to the general principles of Swedish contract law.

v Damages and remedies

Punitive or exemplary damages are not available under Swedish law. Damages are awarded only for financial losses actually sustained. The object of damages is, at least as a starting point, to restore the aggrieved party's financial situation as if the damaging event had never occurred. Therefore, courts will compare the aggrieved party's actual financial situation with the hypothetical financial situation in the absence of the damaging event (the 'differential' method).

In general, the claimant bears the burden of proof in relation to the losses suffered and the causal link between the loss and the breach. The loss must also not be too remote (i.e., proximity must be demonstrated). The claimant further needs to demonstrate that it is possible to calculate the alleged loss with reasonable certainty. If proof regarding the quantum of the loss cannot be adduced (or can only be adduced with difficulty), the court may estimate the loss at a reasonable amount. This may also be done where the production of the relevant evidence can be expected to entail costs or inconveniences out of reasonable proportion to the extent of the loss, and the amount of the claimed damages is minor.39 It should be noted that this rule of alleviation of evidentiary burden relates to the quantum only and not to the presence of an actual loss.

III PUBLIC ENFORCEMENT

i Forms of action

Public enforcement actions may be divided into two main categories:

a administrative and quasi-administrative proceedings, conducted by the SFSA and the relevant exchange respectively; and

criminal proceedings conducted by the SNECA before the criminal courts.

39 Chapter 35, Section 5 of the CJP
Administrative actions

The SFSA may commence administrative proceedings to determine whether a breach of securities laws has occurred, and it is entitled to impose sanctions that can be appealed before administrative courts. The range of supervisory and investigatory powers available to the SFSA has increased as a result of the MAR.

The supervisory and investigatory powers of the SFSA include the power to:

a. request information from market participants and disclosure of relevant documents;
b. summon and question any person who might possess relevant information;
c. carry out on-site inspections;
d. suspend trading of the financial instrument concerned;
e. require the temporary cessation of any practice that the SFSA considers contrary to the MAR;
f. refer matters for criminal investigation;
g. impose a temporary prohibition on the exercise of professional activity; and
h. take all necessary measures to ensure that the public is correctly informed, inter alia, by correcting false or misleading disclosed information, including by requiring an issuer or other person who has published or disseminated false or misleading information to publish a corrective statement.

Furthermore, in relation to insider trading and market manipulation, the SFSA may impose pecuniary sanctions against both natural and legal persons.40

Quasi-administrative actions

As a result of the legislator having delegated a degree of authority and standards-setting to the self-regulation system, the ongoing supervision of issuers is mainly exercised by the relevant stock exchange. As noted above, the listing and takeover rules of the NSE indirectly implement EU legislation in the field of securities law and the stock exchange is also responsible for monitoring compliance with its rules. The SFSA seeks to ensure that the stock exchanges enforce their rules correctly in relation to the issuers.

In the event of a failure by the issuer to comply with the stock exchange’s rules, the exchange may, if the violation is serious, decide to delist the issuer’s traded financial instruments, or, if delisting is considered unsuitable, impose a fine corresponding to not more than 15 times the annual fee paid by the issuer to the exchange.41 Where the non-compliance is of a less serious nature or is excusable, the exchange may issue a reprimand.

The NSE has a Disciplinary Committee to adjudicate and sanction breaches of the listing rules. In the event of a suspected violation, the exchange initially issues a written request for an explanation from the issuer concerning the matter at hand. The issuer shall, upon request by the exchange, supply the exchange with the information it requires to determine whether there has been a breach. Detailed provisions about the Disciplinary Committee are set forth in the SMA and in regulations issued by the SFSA.

40 The maximum sanction for market manipulation for natural persons has previously been raised from €100,000 to €5 million and for legal entities from €10 million to €15 million or from 10 per cent of the total annual turnover to 15 per cent.

41 The annual fee is based on the average market capitalisation for the previous year (December to November). The minimum fee is 205,000 kronor and the maximum fee 3,105,000 kronor.
Criminal actions

According to the MAR, stock exchanges, multilateral trading facilities and persons professionally executing transactions are obligated to report any observed trade orders or transactions that can be assumed to be related to insider trading, market manipulation or unlawful disclosure of insider information, or attempts at such conduct. In accordance with the Market Abuse Act, the SFSA submits these matters to prosecutors at the SNECA, who start a criminal investigation. The SFSA itself may not initiate criminal proceedings.

Prosecutors are obliged, under the CJP, to conduct a criminal investigation when informed that a crime might have been committed. During the investigation, the prosecutor may, among other things, examine witnesses, gather documentary evidence and under certain circumstances use wiretapping and other means of coercion. Normally the SFSA and SNECA collaborate closely and exchange information. Suspects have no obligation to cooperate with either the court or the prosecutor or to produce evidence.

Legal persons cannot be held liable for criminal offences. Criminal liability is instead attributed to directors or representatives of the entity issuing the security. The sanctions that the court may impose vary depending upon the type of criminal offence, and some offences (e.g., serious insider trading and serious market manipulation) can be punishable with up to six years of imprisonment. Less serious instances of such criminal offences could be punishable with a fine. If convicted, the defendant has the right to appeal before the Court of Appeal.

If administrative sanctions have been imposed on a defendant by the SFSA, prosecutors are precluded from imposing further (criminal) sanctions on the defendant (provided that the matter concerns the same market abuse infringement). However, if the SFSA has not imposed administrative sanctions, the prosecutor is under a duty, alongside the prosecution, to file a motion for administrative sanctions. This might appear contradictory given the prohibition of ne bis in idem, but given that the criminal burden of proof is harder to satisfy than the administrative burden of proof, the idea is that the court shall adjudicate upon the administrative action only if the prosecutor fails to sufficiently substantiate the criminal offence.

ii Settlements

Settlement of administrative actions undertaken by the SFSA is not possible under Swedish law. Nor are settlements available in criminal proceedings, and there is no equivalent of plea-bargain agreements.

42 Chapter 20, Section 6 of the CJP.
43 Chapter 3, Section 7 of the Market Abuse Act (this means that the administrative sanctions are considered to fall within the scope of the ne bis in idem principle).
44 Chapter 4, Section 1, of the Market Abuse Act.
45 Chapter 4, Section 1, Paragraph 2 of the Market Abuse Act.
IV CROSS-BORDER ISSUES

i Jurisdiction under EU Regulation No. 1215/2012

Jurisdictional issues are governed by the Brussels I bis Regulation (Brussels I), provided that the respondent is domiciled in an EU Member State. A respondent not domiciled in a Member State is, in general, subject to national rules of jurisdiction. However, there are a few exceptions. For example, national rules of jurisdiction do not apply regardless of whether the respondent is domiciled in a Member State or not if a matter falls within the scope of Article 17 of Brussels I (consumer contracts).

The general rule of jurisdiction under Brussels I is that the courts of the Member State in which the respondent is domiciled will have jurisdiction to hear the dispute, regardless of the respondent’s nationality (Article 4). An action may also be brought against a respondent in the courts of a Member State other than the Member State in which the respondent is domiciled in the cases mentioned in Articles 7–23 (rules of special jurisdiction). It must be stressed that it is only possible to depart from the general rule in the specific cases expressly provided for in Brussels I.

Special rules of jurisdiction apply in matters relating to, for example, contracts (Article 7.1.a), tort (Article 7.2) and consumer contracts (Articles 17–18). In the controversial judgment Kolassa v. Barclays Bank, the Court of Justice of the European Union (CJEU) for the first time decided which, if any, of these special jurisdictional grounds are applicable for claims against an issuer of securities based on an allegedly false or misleading prospectus.

In the case at hand, Mr Kolassa, domiciled in Austria, acquired certain financial instruments issued by Barclays UK. Barclays did not sell the instruments directly to Mr Kolassa. Rather, the acquisition was made through the local investment firm direktlange.at. It later turned out that the instruments had lost their value. As an investor having suffered loss, Mr Kolassa brought an action before the Handelsgericht Wien seeking the payment of approximately €73,705 in damages on the basis of the contractual, pre-contractual, tortious or delictual liability of Barclays Bank. According to Mr Kolassa, the prospectus issued by Barclays contained errors, and he submitted that he would not have made the investment had Barclays disclosed all relevant information as required by law.

The CJEU first looked at contractual grounds of jurisdiction, namely for consumer contract claims under Article 17, and for contractual matters under Article 7.1.a. The CJEU decided that neither of these provisions could be applied, since no contract between the parties was entered into in the case at hand. It is not entirely clear whether or not a contract would be deemed to have existed if Mr Kolassa had instead acquired the instruments directly from Barclays.

47 Article 6 of the Brussels I Regulation.
48 There are also exclusive jurisdiction provisions (Article 24) and provisions governing prorogation agreements (Articles 25–26).
49 In which case the courts for the place of performance of the obligation in question have jurisdiction.
50 In which case the courts for the place where the harmful event occurred or may occur have jurisdiction.
51 In which case the courts for the place where the consumer is domiciled have jurisdiction.
53 Paragraphs 35 and 41 of the judgment. It may be noted that settled case law gives different interpretations to the notions of contract in the context of Articles 17 and 7.1.a of the Regulation. Article 7.1.a does not
After discarding the contract rules, the CJEU focused on Article 7.2 and found that the claim was delictual in nature. According to Article 7.2, the courts for the place where the harmful event occurred or may occur have jurisdiction alongside the court where the respondent is domiciled. According to established case law, the expression ‘place where the harmful event occurred or may occur’ covers both the place where the damage occurred and the place of the event giving rise to it, meaning that the respondent may be sued, at the option of the applicant, in the courts for either of those places. As regards the place of the event giving rise to the damage, the CJEU ruled that this place was where Barclays had its seat (the United Kingdom), given that all relevant decisions concerning the arrangement for the investment proposed by Barclays and the content of the relevant prospectus had been taken there. As regards the localisation of damage, the CJEU ruled that this place was where the domicile of Mr Kolassa had jurisdiction, ‘in particular when the loss itself occurred directly in the investor’s bank account and if that bank account is held with a bank established within the jurisdiction of these courts’. It is unclear whether the reference to the bank account refers to the securities account or the account from which the securities were paid.

The Kolassa case leaves many questions unanswered and the issue of jurisdiction for claims against an issuer of securities based on an allegedly false or misleading prospectus remains uncertain. It will not be possible to make a clear determination of the competent court in prospectus liability suits until the CJEU has had a chance to clarify the scope and closer meaning of its ruling in Kolassa.

ii Jurisdiction under national rules

If the respondent is not domiciled in an EU Member State, and provided that the matter does not fall within the scope of Article 17 of Brussels I (consumer contracts), Swedish national rules on jurisdiction will apply. These are set out in Chapter 10 of the CJP.54

Where the respondent has residence outside Sweden, the main rule provides that the district court in the place where the respondent is sojourning has jurisdiction.55

Other courts of Sweden have jurisdiction alongside the court where the respondent is sojourning in the following cases:

- Section 3 allows jurisdiction for the district court in the place where the respondent’s property is located.56

54 It should be noted that these rules determine the internal jurisdiction, but they are considered applicable ex\alan\logia in international disputes.
55 Chapter 10, Section 1, Paragraph 5 of the CJP.
56 The property must have some asset value. Furthermore, it follows from the Supreme Court case NJA 1981, p. 386 that a Swedish court may not exercise jurisdiction over a foreigner that has property intended for his or her personal use during a temporary stay in Sweden.
In matters relating to contracts, Section 4 allows jurisdiction for the district court in the place where the contract was entered into.\(^{57}\)

In matters relating to tort, Section 8 allows jurisdiction for the district court in the place where the tortuous act occurred or had its impact.

In matters relating to consumer contracts, Section 8a allows jurisdiction for the district court in the place where the consumer resides if the claim amounts to less than approximately 22,000 kronor. The general jurisdiction rules are applicable in consumer disputes exceeding the mentioned amount.

Section 6 allows jurisdiction for the courts in the place where a business establishment is located, provided that the dispute arises directly out of the business activity carried out at the establishment. Unrelated claims are therefore not sufficient for jurisdiction.

### iii Conflict of law issues

The governing law of contracts will be determined in accordance with the Rome I Regulation.\(^{58}\)

The basic principle is that the parties are free to choose the governing law of their contract.\(^{59}\) To the extent that the law applicable to the contract has not been chosen by the parties, the law governing the contract shall be determined in accordance with Article 4.1, Rome I, which contains different choice-of-law rules for different types of contract. Where the contract may not be categorised as being one of the specified types or where its elements fall within more than one of the specified types, it is to be governed by the law of the country where the party required to effect the characteristic performance of the contract has his or her habitual residence (Article 4.2).\(^{60}\) However, where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in Articles 4.1 or 4.2, the law of that other country shall apply (Article 4.3).\(^{61}\)

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\(^{57}\) The provision requires that the contract must have been entered when the respondent or his or her legal representative was in Sweden. It is thus not sufficient that a preparatory negotiation has taken place within Sweden. Moreover, in NJA 1940, p. 354, the Supreme Court stated that a contract concluded by telephone between a Swedish company and a foreign company is not sufficient for jurisdiction.


\(^{59}\) The freedom of contract is subject to certain exceptions; for example, in relation to overriding mandatory provisions (Article 9, Rome I Regulation).

\(^{60}\) There is a special choice-of-law rule for certain types of financial contracts set forth in Article 4.1(h). Pursuant to that article, a contract concluded within a multilateral system that brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments, as defined by Article 4(1), point (17) of Directive 2004/39/EC, in accordance with non-discretionary rules and governed by a single law, shall be governed by that law. The exact scope of this Article is to some extent unclear, but our understanding is that it encompasses contracts relating to financial instruments that have been concluded within a regulated market or a multilateral trading facility by financial entities that have special permission to trade in such organised financial markets. Thus, contracts concluded between such financial entities and their clients are not included in this category.

\(^{61}\) Where the applicable law cannot be determined either on the basis of the fact that the contract can be categorised as one of the specified types or as being the law of the country of habitual residence of the party required to effect the characteristic performance of the contract, the contract shall be governed by the law of the country with which it is most closely connected (Article 4.4).
The governing law of matters relating to tort will be determined in accordance with the Rome II Regulation (Rome II). The basic rule is that the law applicable to a tort claim is the law of the country in which the damage occurs (lex loci dammni), irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country or countries in which the indirect consequences of that event occur.

The Kolassa ruling may have ramifications for the determination of the applicable law according to Rome I and Rome II, especially as regards what is to be understood by the notions ‘contract’ and ‘tort’, given the principle of parallel interpretation between the Brussels and the Rome Regulations.

### iv Criminal jurisdiction

A Swedish court may exercise jurisdiction over crimes committed outside Sweden according to Swedish law where the crime has been committed:

- **a** by a Swedish citizen or an alien domiciled in Sweden;
- **b** by an alien not domiciled in Sweden who, after having committed the crime, has become a Swedish citizen or has acquired domicile in Sweden or who is a Danish, Finnish, Icelandic, or Norwegian citizen and is present in Sweden; or
- **c** by any other alien, who is present in Sweden, and the crime under Swedish law can result in imprisonment for more than six months.

There are also a few other rules that allows Swedish courts to exercise jurisdiction over crimes committed outside Sweden according to Swedish law (e.g., if the least severe punishment prescribed for the crime in Swedish law is imprisonment for four years or more).

### V YEAR IN REVIEW

The Swedish courts and authorities are in the process of establishing a new practice following the new laws and amendments that MiFID, MiFIR and MAR gave rise to and that came into effect during 2017. Similar to the situation in 2018, only minor changes have been made in the relevant regulations during 2019. By way of example, a few minor new chapters in the Financial Instruments Trading Act have been introduced.

During 2019, the SFSA increased its money laundering supervision and invested considerable resources in examining some of Sweden’s major banks’ measures against money laundering in their Baltic subsidiaries. The SFSA imposed fines on a few of these banks and
initiated misdemeanour cases due to the banks’ failures to take the required measures to combat money laundering. The outcome of the cases that has attracted the most attention is expected to be communicated in June 2020.\textsuperscript{67}

A judgment was rendered in one of the most high-profile cases in Sweden in recent years. The case involved a Swedish finance company that offered financial services to private individuals regarding inter alia, pensions, insurance and loans. The case mainly focused on two securities transactions made by the finance company’s funds during 2012. The grounds for the charges were mainly that the finance company allegedly bought securities for investors’ pension earnings at an excessively high price and that the excess price, which included an excessive fee, was allegedly used to benefit the company’s owners through bribery. The charges related to breach of trust, bribery and accounting offence. The defence argued that that investors were not deceived and that the value of the pension earnings had not been lost. The defence further stated that had the transactions not taken place, the investors would have had 120 million kronor less in their accounts. The district court found that it was not proven that the price and fees had been excessive in relation to the nature and extent of the securities transactions. Consequently, the charges were not found to be substantiated and the defendants were acquitted. The judgment has been appealed to the Court of Appeal.

VI OUTLOOK AND CONCLUSIONS

In our opinion, investor protection has still, to a certain extent, been neglected in Sweden as civil liability for making false or misleading statements in prospectuses so far has proven ineffective as regards private securities litigation. In 2013, the Swedish government proposed that the rules regarding civil liability for prospectuses shall be amended to include, inter alia, express liability for the company itself and the advisers participating in the preparation of the prospectus.\textsuperscript{68} The proposal has not yet led to any law reforms.

There are currently several proposals regarding money laundering supervision under review within the EU. One of these proposals regards a regulation that, if adopted, would further harmonise the states’ money laundering legislation.\textsuperscript{69} The Swedish government is nevertheless still determined to combat money laundering and has therefore initiated an investigation, the aim of which is to suggest further additional measures. Among others, the banks’ role in money laundering schemes is likely to be focused upon. Due to a few high-profile cases concerning subsidiaries to Swedish banks in the Baltics, the SFSA is focusing on coordinating its cooperation with the Baltic authorities.

\textsuperscript{68} Ds 2013:16.
\textsuperscript{69} FI:s arbete mot penningtvätt och finansiering av terrorism, Finansinspektionen, 15 November 2019.
I OVERVIEW

i Sources of law

In light of the international developments in the area of financial market regulation, Switzerland has completely revised its financial market regulation in recent years. On 15 June 2018, Swiss parliament adopted the Financial Services Act (FinSA) and the Financial Institutions Act (FinIA). This legal framework is a response to the shortcomings of the former legal situation. FinSA aims to protect investors from improper behaviour by financial service providers and to strengthen investor confidence in a stable and functioning market. As of 1 January 2020, FinSA and FinIA entered into force with their implementing regulations.

The new regulations, inter alia, govern the law on prospectus liability. Previously, the prospectus duty for financial products was dispersed throughout various laws and regulations, which is why it lacked consistency. Owing to the enormous size of most of the prospectuses, an assessment of the products was difficult, and (other than in the area of collective investment schemes) concise product documentation that is easy to understand was rarely available. The options for investors to assert their rights were severely restricted and entailed high cost risks.

Now, the former, very brief provisions of the Swiss Code of Obligations (CO) have been replaced by a uniform set of rules set out in FinSA.

FinSA is based largely on EU law (MiFID, Prospectus Directive, PRIPs project) with adjustments made to reflect specific Swiss circumstances. It encompasses cross-sector rules for offering financial services and distributing financial instruments and provides clients with the necessary tools to assert their claims. FinIA essentially harmonises the authorisation rules for financial service providers (other than banks and insurance companies) by introducing a prudential supervision of managers of individual client assets, managers of the assets of occupational benefits schemes and trustees.

In addition to the new regulations, civil law continues to be an important legal source. The following provisions are particularly relevant: Article 41 CO as the basic torts provision,
the provisions on agency in Articles 394 et seq. CO and finally the provisions with regard to companies limited by shares in Article 620 et seq. CO as well as concerning negotiable securities in Article 965 et seq. CO.

Civil domestic litigation is regulated in the Swiss Civil Procedure Code (CPC) and the Federal Statute concerning the Federal Supreme Court (SCS). With regard to international litigation, in particular, the International Private Law Act (PILA), the Lugano Convention (LC) and numerous international treaties are relevant.

In the field of public law, trading in securities is governed by the Federal Act on Financial Markets Infrastructures and Market Conduct in Securities and Derivatives Trading (FMIA). Further, the Collective Investment Schemes Act (CISA) may also be applicable. The organisation of the Swiss Financial Market Supervisory Authority (FINMA) and its supervisory instruments are set out in the Financial Market Supervision Act (FINMASA).

The administrative procedure is regulated in the Administrative Procedure Act. When it comes to the prosecution of criminal offences under the FMIA, the Swiss Criminal Procedural Code (SCP) and the Federal Act on the Organisation of the Criminal Prosecution Authorities regulate the criminal procedure and the competent authorities.

ii Regulatory authorities

FINMA is given certain general powers and tools to enforce the provisions of the Swiss financial market laws and additional specific instruments, such as to proceed against the failure to disclose shareholdings, insider trading and market manipulation. In this regard, the supervisory authority checks whether the rules of conduct of FinSA are observed with respect to supervised financial service providers. It should be noted that FinSA has introduced a comprehensive and standardised prospectus obligation for securities. Under the new regime, all prospectuses will be subject to an approval process. In particular, they must be submitted to a new reviewing body prior to their publication, which has been approved by FINMA. The board will review the prospectus for completeness, coherence and comprehensibility.

While FINMA is entitled to take administrative measures under FINMASA, the Federal Department of Finance is generally responsible for prosecuting violations of the criminal provisions of the financial market acts, unless provided otherwise. The Attorney General of Switzerland is entrusted with the prosecution of market manipulation and insider trading.

iii Common securities claims

Lawsuits for breaches of securities law are rare in Switzerland. Consequently, there are only a few precedents available. There may be several reasons for there being so little case law, including:

- the cost of litigation is high, with a prohibition on contingency fees and a loser-pays rule;
- there are no instruments for mass claims; and

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5 Article 29 et seq. FINMASA.
6 Article 144 et seq. FMIA.
8 Article 50 Paragraph 1 FinSA.
9 Articles 51 et seq. FinSA.
10 Article 50 Paragraph 1 FINMASA.
11 Article 156 Paragraph 1 FMIA.
the burden of proof often lies on the investor, leading to a high litigation risk and a rather litigation-averse attitude.

A preliminary draft amendment to the CPC provided for provisions to remedy these shortcomings. Yet, due to disagreement in the advisory procedure, the Swiss Federal Council decided to treat the issue of collective redress in a separate motion. There is, however, a new feature in the area of dispute resolution: any dispute between a client and its financial service provider may be settled by an ombudsman in mediation proceedings. This provision aims to implement a non-bureaucratic, fair, quick and impartial conflict resolution.

As there was no public supervision of securities offerings, the public enforcement of securities claims so far mainly related to matters such as insider trading, market disruption, reporting duties, the duty to make an offer, and wrong or missing information in a prospectus. It remains to be seen whether the new regulatory regime will result in additional public enforcement actions.

II PRIVATE ENFORCEMENT

Forms of action

Prospectus liability

FinSA replaces the previous prospectus law of the CO (Article 652a and Article 752 as well as Article 1156 CO). The basic provision for actions regarding prospectus liability is now regulated in Article 69 FinSA, which reads as follows (informal translation):

1 Any person who fails to exercise due care and thereby furnishes information that is inaccurate, misleading or in violation of statutory requirements in prospectuses, key information documents or similar communications is liable to the acquirer of a financial instrument for the resultant losses.
2 With regard to information in summaries, liability is limited to cases where such information is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus.
3 With regard to false or misleading information on main prospects, liability is limited to cases where such information was provided or distributed against better knowledge or without reference to the uncertainty regarding future developments.

Scope of application

With regard to liability, the following provisions are relevant for the interpretation of Article 69 FinSA: Article 3 FinSA for the definition of financial instruments, Article 35 FinSA for the duty to publish a prospectus, Articles 36 to 39 FinSA for exemptions of this duty and Article 40 FinSA for the necessary content of a prospectus.

12 Article 74 FinSA.
14 Article 75 Paragraph 1 FinSA.
15 Article 154 FMIA.
16 Article 155 FMIA.
17 Article 151 FMIA.
18 Article 152 FMIA.
19 Article 148 Paragraph 1 lit. f CISA.
Generally, Article 69 FinSA largely takes over the regulatory content of the former prospectus liability under Article 752 CO. Accordingly, the subject of liability concerns standardised information, which does not meet the legal requirements. Yet there are subtle differences between the former and the new liability. Article 69 FinSA has a wider scope of application, because liability is not related to a specific product but worded neutrally. Therefore, the subject of liability now not only includes prospectuses but also key information documents or similar communications intended for the use of investors. The three main client segments are private clients, professional clients and institutional clients. In particular, the prospectus requirements concerning private clients have been extended. Now, as a rule, a producer must first produce a key information document, where it offers a financial instrument to retail clients. This brief documentation is intended to enable private clients to make informed investment decisions and compare different financial instruments.

On the other hand, the law also provides for various exemptions, depending on the offer itself (e.g., its addressees, the number of addressees, value, etc.) and the type of securities offered. Among others, offers addressed to professional clients would not require a prospectus.

Further, FinSA requires the prior publication of a prospectus in two cases: when a public offer to purchase securities is made (issue) and when securities are admitted to trading on a stock exchange (listing). Subject to expressly regulated exceptions, FinSA requires a prospectus for all equity and debt securities, including derivatives and structured products. This product-neutral framework is based on the European Prospectus Directive (2003/71/EG). It should also be noted that liability extends to documents that refer to the prospectus in accordance with Article 44 FinSA.

Additionally, the liability according to Article 69 FinSA has adopted the case law on Article 752 CO. Previously, the Swiss Federal Court had extended Article 752 CO contrary to its wording to buyers on the secondary market. This extension equally applies under the new legal regime as per Article 69 FinSA. Finally, liability for information in the summary shall be assumed only if it is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus.

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20 Dispatch on the Financial Services Act (FinSA) and the Financial Institutions Act (FinIA), 15.073, of 4 November 2015, p. 8992.
21 Article 35 FinSA.
22 Article 58 FinSA.
23 Article 68 FinSA.
24 Article 58 FinSA.
26 Articles 38 et seq. FinSA.
30 Dispatch on FinSA and FinIA (footnote 20), p. 8993.
31 DFT 131 III 306, 308 E. 2.1.
33 Article 69 Paragraph 2 FinSA.
Loss

Damages are calculated based on the ‘theory of difference’, comparing the aggrieved party’s financial situation with the hypothetical financial situation if the harming event had not occurred. In the frame of prospectus liability, damages usually occur only after the public learns of the inadequacy of the information provided in the prospectus. They are calculated as the difference between the actual paid issue price based on the flawed prospectus and the actual price after the public learns about its inadequacy, factoring out general market developments.

Violation of duty

Liability under Article 69 FinSA arises if information is inaccurate (i.e., not objectively correct), misleading (i.e., conceals or omits relevant facts) or in breach of a statutory duty (i.e., if it does not comply with statutory prerequisites, in particular if it is incomplete). The statutory duties are defined in Article 40 FinSA. According to this provision, the prospectus shall contain the essential information for the investor’s decision on the issuer, the guarantor or other security providers (if any), the securities and the offer. Compared to the previous regulation, the scope of the statutory duties has been expanded considerably. Accordingly, the prospectus must contain the associated risks for investors with regard to the securities and the offer. The detailed requirements for the offering of securities and other financial instruments are governed by FINSO.

Under FinSA, future (i.e., forward-looking) information may also cause liability, yet the consequences are limited to cases where information was provided against better knowledge or without referring to the uncertainty of future developments. With this regulation FinSA follows the US securities law, which has a similar regulation with the so-called bespeaks caution doctrine.

Apart from the above, liability may be based on tort in accordance with Article 41 CO. Liability in tort requires violation of a provision protecting the concerned financial asset; in particular, Article 152 Criminal Code regarding false statements about commercial businesses. Remarkably, exploitation of insider information or market manipulation are

34 Ingeborg Schwenzer, Schweizerisches Obligationenrecht, Allgemeiner Teil (Seventh Edition, Berne, 2016), No. 14.03.
37 As set out in Articles 652a, 653d–653f, 656a and 1156 CO and the Listing Rules of the SIX Swiss Exchange. With regard to open-ended collective investment schemes, Articles 75–77 CISA determine the prospectus duties.
38 Watter (footnote 41), Article 752 No. 18 et seq.
39 Article 1 lit. b FINSO.
40 Article 69 Paragraph 2 FinSA.
41 Bohrer/Rehm/Huggenberger/Spiegel/Vollenweider (footnote 46), p. 45.
43 Article 154 FMIA.
44 Article 155 FMIA.
said to serve the aim of equal treatment of all investors and the protection of the market's efficiency and may, therefore, not serve as basis for a tort claim. With FinSA, however, new criminal provisions have entered into force, the violation of which can also be the basis for tortious liability under Article 41 CO. In this regard, Article 89 lit. a FinSA states that providing false information or withholding material facts can be punished by up to 100,000 Swiss francs. Further, Article 90 FinSA punishes the violation of the prospectus regulations and key information documents with a fine of up to 500,000 Swiss francs. Generally, since FinSA is public law in nature, it remains to be seen which regulations qualify as protective provisions and thus may trigger liability under Article 41 CO.

Another basis for a damages claim may be breach of trust. The requirement is that a special relationship exists between the investor and the liable person, creating legitimate expectations of the investor and disloyal disappointment of such expectations. In a landmark decision, the Federal Supreme Court held that an expert may be liable to a third party based on created expectations even if there is only an indirect connection – for example, if the customer or client passes on the expert report to a third party and the expert could have anticipated the dissemination.

**Causation**

For causation, there is a distinction between actual cause and legally proximate cause. In the context of prospectus liability, causation reflects two aspects. On one hand, the violation of duty must have caused the claimed damages (actual cause). On the other hand, there is the question whether the inadequacy in the prospectus actually influenced the decision to acquire the securities for the respective price (legally proximate cause).

With regard to the latter, the legislator refrained from including a presumption between incorrect prospectus content and purchase decision. The fraud on the market doctrine is, therefore, still not implemented. Accordingly, the investor must prove reliance on inadequate information provided by the prospectus, and that he or she would not have purchased the securities, or would have done so at a lower price with adequate information. Since it is

45 Decision of the Swiss Federal Criminal Court dated 12 September 2018 No BB.2017.123, Cons. 1.5. with regard to insider information. The considerations there are applicable also to market manipulation.
46 Amadò, AJP 2018, 990, 999.
47 Liability based on created expectations includes also liability concerning the breach of pre-contractual duties when negotiating a contract, known as *culpa in contrahendo*, Thomas Jutzi, Unternehmenspublizität Grundlinien einer rechtlichen Dogmatik zur Offenlegung von unternehmensbezogenen Informationen, 2017, No. 581 w.f.r.; Hans Capsar von der Crone/Olivier Baum, Aktienrechtliche Verfahren: Klagemöglichkeiten und Klagerisiken, GesKR 2016, 278, 290; Dieter Gericke/Stefan Waller (footnote 47), Article 754 No. 24.
48 DFT 133 III 390, 395.
49 DFT 130 III 345, Cons. 2.1 et seq.
50 DFT 132 III 718, Cons. 2.1.
51 Watter (footnote 41), Article 752 No. 26.
52 Dispatch on FinSA and FinIA (footnote 20), p. 8993.
53 DFT 132 III 718, Cons. 2.1. and Cons. 3.2.
usually not possible to strictly prove causation, the Swiss Supreme Court ruled that a lower standard of proof shall apply for causation, namely preponderant probability. 54 This also applies under the new legal framework. 55

In cases where liability is based on the failure to publish a prospectus or to disclose certain information, the investor must demonstrate that there was a duty to act. There is causation if compliance would have prevented the loss or if it influenced the decision to acquire the securities. 56

**Fault**

According to general civil law standards, a party may only become liable when at fault. Fault includes both intentional and negligent actions. The scale that is applied to fault is an objective one as compared with the skills and knowledge of an average reasonable person acting in the market.

Article 69 FinSA does not explicitly stipulate an intentional or negligent liability. The provision instead refers to the failure to exercise due care. It is not clear whether the legislator intended to establish a causal liability (strict liability). 57 In the case of strict liability, the fault of the person who caused the damage does not need to be established. 58 In any case, the differences from the previous law will still have to be determined by the courts. 59

**Standing to sue and to be sued**

In accordance with Article 69 FinSA, anyone who purchases financial instruments can act as claimant. This includes not only the first buyer, but also any later acquirer as far as the information in the prospectus was causal for the decision to acquire the financial instruments. 60 The body of creditors 61 and the company itself are not entitled to sue. 62

On the other hand, liability extends to a person who furnishes the inaccurate information. Thus, only the issuer of information can be held liable. This was controversial over a fairly long period of time. The Swiss parliament had discussed whether, in addition to the issuer, anyone who contributed to the information should in fact be liable. In line with Article 752 CO, the previous regulation, this would have included the distributor of the prospectus, especially consortium banks and financial institutions. 63 Following lengthy discussions, the Swiss parliament rejected extensive liability, arguing that the distributor has no possibility to influence the contents of the instruments and documents. 64

54 DFT 132 III 718, Cons. 3.2.1.
55 Dispatch on FinSA and FinIA (footnote 20), p. 8993.
56 BGE 123 III 110, Cons. 3(a).
57 Against this see Bohrer/Rehm/ Huggenberger/Spiegel/ Vollenweider (footnote 46), p. 44.
60 DFT 131 III 306, Cons. 2.1.
61 DFT 113 II 283, 289 et seq.
62 Watter (footnote 41), Article 752 Nos. 9, 9a.
63 Watter (footnote 41), Article 752 No. 10.
Burden of proof

The revision of Article 69 FinSA raised a debate on the applicable burden of proof. To improve the position of investors, the preliminary draft provided for a reversal of the burden of proof. Accordingly, any person who contributed to the prospectus would have to prove that he or she was not at fault. In practice, this version would have required proving a negative fact, which poses important difficulties. The Swiss parliament finally insisted on the general allocation of the burden of proof in civil law. As a consequence, proof of the damage, the breach of duty (inaccurate, misleading or insufficient information in the prospectus) and the adequate causal link between the damage and the breach of duty must be proved by the injured party.

Statute of limitations

The prospectus liability pursuant to Article 69 FinSA is of private law nature. Absent any provision contrary to FinSA, the claim is therefore subject to the 10-year limitation period pursuant to Article 127 CO. As opposed to the former statute of limitations of five years under Article 760 CO, the limitation period has thus been doubled. In the event that the claim derives from a criminal action for which the criminal law stipulates a longer statute of limitations, the latter also applies to the civil claim.

Breach of simple agency agreement

Investors often seek advice before buying financial instruments or delegate portfolio management. Investors may bring actions for damages claiming that the portfolio management or the investment advice was not diligent or was not in the investor’s interest. The underlying legal relationship is subject to the provisions of simple agency pursuant to Article 394 et seq. CO. Thus, claims against asset managers, investment advisers, banks and securities firms will often be based on an alleged breach of simple agency agreements.

Loss

Loss is calculated by comparing the investor’s actual financial position with the position as it would have been if the required care and loyalty had been applied and the simple agency agreement had, hence, been fulfilled properly. The amount that may be claimed consists of both the reduction of assets due to improper investment and loss of profit.

Violation of duty

Liability may arise based on Article 398 Paragraph 2 in connection with Article 97 Paragraph 1 CO:

65 Dispatch on FinSA and FinIA (footnote 20), p. 8992.
66 Bohrer/Rehm/ Huggenberger/Spiegel/ Vollenweider (footnote 46), p. 44.
68 Dispatch on FinSA and FinIA (footnote 20), p. 8992.
69 In portfolio management, the asset manager has an obligation to make the investment decisions and adopt the investment strategy, whereas an investment adviser is only supposed to give investment advice but not act on its own. Christoph Gutzwiller, Schadensstiftung und Schadensberechnung bei pflichtwidriger Vermögensverwaltung und Anlageberatung, SJZ 2005, 359.
70 Gutzwiller (footnote 86), SJZ 2005, 357, 362.
Switzerland

violations of the duty of care; breach of the obligation of loyalty; or failure to comply with investor’s instruction.  

In the field of asset management and investment advice, the duty of care is specified, inter alia, in the Portfolio Management Guidelines issued by the Swiss Bankers Association. Although these guidelines constitute self-regulation (rather than statute) and target Swiss banks, they may be considered as general standards of care with regard to securities dealers. 

One of the common subjects of dispute is whether the violation of duty was ratified: for example, if the investor never objected to the custody account statements that were duly delivered.

The interpretation of the civil liability provisions is highly likely to be affected by FinSA. Although the relationship between civil liability and the public regulatory law is not entirely clear, there are indications that FinSA will have an impact on private law. This follows from the fact that the legislator apparently opted for the so-called concept of radiation (Ausstrahlungswirkung) between the two areas of law. Accordingly, regulatory and private law shall complement each other indirectly, mutually and ‘where necessary’. This interpretation could also mean that civil courts will consider supervisory orders such as FINMA circulars, which specify the obligations of financial service providers, when interpreting the private law provisions of FinSA. In particular, FinSA provides for various duties of care, protection of interests and loyalty (namely duties of information, appropriateness testing and documentation), which are to be regarded as a concretisation of Article 398 CO. 

Caution under the simple agency agreement requires both actual cause and legal proximate cause. The investor will have to show that the loss would not have occurred or would be lower if the financial intermediary had acted in compliance with his or her contractual duties. Under simple agency law, preponderant probability rather than strict proof is sufficient to establish legal proximate cause.

**Causation**

Causation under the simple agency agreement requires both actual cause and legal proximate cause. The investor will have to show that the loss would not have occurred or would be lower if the financial intermediary had acted in compliance with his or her contractual duties. Under simple agency law, preponderant probability rather than strict proof is sufficient to establish legal proximate cause.

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71 These obligations are based on Article 398 Paragraph 2 CO; Gutzwiller (footnote 86), SJZ 2005, 357, 360.
73 Gutzwiller (footnote 86), SJZ 2005, 357, 358.
74 Gutzwiller (footnote 86), SJZ 2005, 357, 361, 236.
78 DFT 120 II 250.
Fault
Any degree of fault is sufficient for a claim under an agency agreement. It is common practice that financial intermediaries exclude liability for slight negligence in the agreement.79

Standing to sue and to be sued
Any investor who is a party to a simple agency agreement is entitled to raise damages claims based on breach of contract. On the other hand, any financial intermediary who is a party of the respective simple agency agreement may be sued.

Burden of proof
An investor claiming damages owing to breach of a simple agency agreement must prove his or her loss, a violation of duty and causation. Fault is presumed, and it is up to the financial intermediary to exonerate him or herself.

Statute of limitations
Claims for damages become time-barred at 10 years80 after the loss occurred.81

Provision of documents
Under FinSA, clients have the right to claim a copy of all the documents and records that the financial service providers keep concerning the specific client and the client relationship. Articles 15 and 16 FinSA and Articles 18 and 19 FinSO determine the scope and the requirements regarding the records that the service provider has to keep. As an example, service providers shall document the financial services agreed with clients82 and shall, upon request of the client, render account of the composition, valuation and development of the portfolio as well as the costs associated with the financial services.83

Articles 72 and 73 FinSA and Article 97 FinSO govern the formal and material aspects of the provision of documents. Upon request, clients must receive a copy of their file and all other documents that the financial service provider prepared within the context of their business relationship.84 The client must submit the request in writing or in another form demonstrable via text.85 The service provider is required to provide the copy within 30 days free of charge.86 By means of FinSA, the client can enforce this right in court if the service provider does not comply with the request.87 Further, the court may consider a refusal to provide the documents in later court proceedings to the disadvantage of the service provider.88

79 Based on Article 100 Paragraph 1 and Article 100 Paragraph 2 CO, liability may not be excluded for unlawful intend or gross negligence in advance.
80 Article 127 CO.
81 DFT 130 III 597.
82 Article 15 Paragraph 1 FinSA.
83 Article 16 Paragraph 2 FinSA.
84 Article 72 Paragraph 1 FinSA.
85 Article 72 Paragraph 1 FinSA.
86 Article 73 Paragraph 2 FinSA.
87 Article 73 Paragraph 3 FinSA.
88 Article 73 Paragraph 4 FinSA.
ii Procedure

With the coming into force of FinSA, investors may seek to solve their disputes by an ombudsman or in domestic proceedings. Under Articles 74 et seq. FinSA, disputes between the client and the financial service provider can be settled by a so-called ombudsman in mediation proceedings. This gives both parties the opportunity to call on an independent, state-recognized institution with specific expertise without limiting their procedural rights.\(^89\) The purpose of the simplified procedure is to protect clients from costly and potentially risky legal proceedings.\(^90\) The proceedings are confidential, so the statements made by the parties and the correspondence between the parties and the ombudsman may not be used in subsequent civil proceedings.\(^91\) A request for mediation with an ombudsman does not exclude a civil lawsuit, but the plaintiff can unilaterally waive the conciliation procedure according to Article 197 CPC after the ombudsman proceedings have been conducted.\(^92\)

In domestic proceedings, a claimant may file an action for prospectus liability either with the court at the respondent’s domicile or registered office, or at the court at the office of the company issuing the securities.\(^93\) In a canton with a commercial court,\(^94\) the commercial court may be competent.\(^95\)

In most cases, court proceedings are preceded by mandatory conciliation proceedings,\(^96\) unless a commercial court has jurisdiction. In addition, the claimant may unilaterally waive conciliation proceedings if the other party resides abroad.\(^97\) In the event the respondent agrees and the amount in dispute is above 100,000 Swiss francs, the parties may waive the proceedings at the first instance and initiate proceedings directly at the cantonal appellate court.\(^98\)

Decisions of the first instance may be appealed to the cantonal appellate courts,\(^99\) followed by appeal to the Swiss Federal Court,\(^100\) whose review, however, is limited to legal issues.\(^101\)

Swiss law does not provide for class actions. The remedies for collective enforcement are very limited. With regard to damages claims, the only option is that claimants with similar or identical claims may together file an action for damages\(^102\) or the courts may join several

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89 Bühler Christoph B., Stärkung der Ombudsstelle, SZW 2019, 559, 559.
90 FINMA-Vertriebsbericht 2010, p. 7.
91 Article 75 Paragraph 2 FinSA.
92 Article 76 Paragraph 2 FinSA; Bühler (footnote 107), SZW 2019 p. 559, 559.
93 Article 40 CPC.
94 There are commercial courts in the cantons of Aargau, Berne, St Gallen and Zurich.
95 Pursuant to Article 6, Paragraph 1 and 2 CPC the dispute must be decided by the commercial court if it concerns commercial activity of at least one party (which will always be the case with regard to Article 69 FinSA), the decision is subject to an appeal with the Swiss Federal Court (if the amount in dispute is of at least 30,000 Swiss francs) and the parties are registered in a commercial registry. In cases where only the respondent is registered in a commercial registry and all the other prerequisites are met, the claimant may choose between the commercial court and the district courts.
96 Articles 197 et seq. CPC.
97 Article 198 lit. f and 199 CPC.
98 Article 8 CPC.
99 Article 308 et seq. CPC.
100 Article 72 SCS.
101 Article 95 et seq. SCS.
102 Article 71 CPC.
proceedings in one proceeding. A group action according to Article 89 CPC is directed at protection of personality rights and enables the group to request only prohibition of a violation, the ending of an ongoing violation or the establishment of a violation, but no claim for damages.

Legal costs are usually imposed on the unsuccessful party. They include court costs and the reimbursement of attorney’s fees. Both are determined based on cantonal tariffs that reflect the amount in dispute and the complexity. Contingency fee arrangements are prohibited.

### iii Settlements

Settlements may be concluded at any time, out of court or in court. In-court settlements qualify as surrogate court decisions that are enforceable and have res judicata effect.

Claims in the context of corporate liability often include multiple persons who are jointly and severally liable (Article 759 CO), for which reason settlements require particular attention. It is strongly debated whether a settlement between only some of the involved persons but not all would have erga omnes effect, meaning that it has effect beyond the parties to the settlement. Thus, even if a settlement is reached, as long as not all potentially liable persons agree to the settlement, the risk of recourse claims exists and can hardly be excluded.

### iv Damages and remedies

See Section II.i at ‘Loss’.

## III PUBLIC ENFORCEMENT

### i Forms of action

The key provisions with respect to public enforcement of securities transactions relate to insider trading, market manipulation, reporting duties, the duty to make a public offer and the duty to provide a prospectus for collective investment schemes. In the event of any breach, administrative measures and criminal sanctions may be imposed.

**Insider trading**

Article 142 FMIA provides that any person who knows or should know that information constituting insider information or who has a recommendation that he or she knows or should know is based on insider information behaves inadmissibly when he or she:

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103 Article 125 lit. c CPC.
104 Article 106 CPC.
105 Article 96 CPC.
106 Article 208 Paragraph 2 and Article 241 Paragraph 2 CPC.
108 Namely, the prospectus liability or the liability for administration, business management and liquidation, the auditors’ liability (Article 69 FinSA and Articles 753 et seq. CO).

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exploits it to acquire or dispose of securities listed in Switzerland or to use financial instruments derived from such securities;  

b discloses it to another; or  
c exploits such information to make a recommendation to another person to acquire or dispose of securities listed in Switzerland or to use financial instruments derived from such securities.

A corresponding, but slightly more restrictive, criminal provision is set forth in Article 154 FMIA.

**Market manipulation**

Article 143 FMIA provides that a person behaves inadmissibly when he or she publicly disseminates information that he or she knows or should know gives false or misleading signals regarding the supply, demand or price of securities listed in Switzerland, or carries out transactions, purchase or sale orders that he or she knows or should know give false or misleading signals regarding the supply, demand or price of securities admitted on a trading venue in Switzerland. The FMIA also sets forth a criminal provision on market manipulation with a narrower scope.  

**Reporting duty**

Anyone who directly or indirectly or acting in concert with third parties acquires or disposes of shares or purchase or sale rights relating to shares of a company with a registered office in Switzerland whose equity securities are listed in whole or in part in Switzerland, or of a company with a registered office abroad whose equity securities are mainly listed in whole or in part in Switzerland, and thereby reaches, falls below or exceeds the thresholds of 3, 5, 10, 15, 20, 25, 33⅓, 50 or 66⅔ per cent of the voting rights, whether exercisable or not, must notify this to the company and to the stock exchanges on which the equity securities are listed.

**Duty to make an offer**

Anyone who directly, indirectly or acting in concert with third parties acquires equity securities which, added to the equity securities already owned, exceed the threshold of 33⅓ per cent of the voting rights of a target company, whether exercisable or not, must make an offer to acquire all of the listed equity securities of the company. Target companies may raise this threshold to 49 per cent of voting rights in their articles of incorporation.

**Non-licensed banking activity**

Professional acceptance of public funds is reserved to banks licensed by FINMA, with a specific exclusion for bond issues. However, if the prospectus does not provide for all required information, the issuer runs the risk of FINMA finding non-licensed banking activity and sanctioning the issuer.
**ii  Procedure**

FINMA may initiate administrative procedures to sanction the above duties. The proceedings are governed by the Federal Act on Administrative Procedures of 20 December 1968. In contrast, the Federal Department of Finance may initiate criminal procedures and impose criminal sanctions in the event that criminal provisions of the FMIA are violated, save that the Attorney General of Switzerland is responsible for prosecuting certain offences, such as the criminal offence of insider trading and market manipulation. The Federal Act on Administrative Criminal Law of 22 March 1974 (ACL) applies to procedures conducted by the Federal Department of Finance while the SCP applies to procedures conducted by the Attorney General of Switzerland.

If the Federal Department of Finance is of the view that the requirements for a custodial sentence or a custodial measure are met, the offence is subject to federal jurisdiction. In such a case, the Federal Department of Finance will refer the files to the office of the Attorney General of Switzerland for proceedings before the Federal Criminal Court.

**iii  Settlements**

**FINMA**

Swiss law does not provide for any specific settlement procedures with FINMA. However, in practice, before opening a formal procedure pursuant to Article 30 FINMASA, FINMA initiates an informal preliminary investigation and when concluded makes an informal proposal to the person concerned on how the matter can be settled without the need (and risks) of a formal procedure. Typically, this applies in cases where no major regulations have been breached and often results in the resignation of the person in question from any managerial functions in the financial industry for a number of years.

**Criminal authorities and Federal Department of Finance**

There is only limited room for settlements in criminal investigations. Articles 52–54 of the Criminal Act provide for possibilities to refrain from prosecution in exceptional circumstances. In cases where financial loss was caused, and the offender made reparation for the injury or made every reasonable effort to right the wrong he or she has caused, the criminal authorities may in particular refrain from prosecution if the requirements for a suspended sentence (i.e., custodial sentence of no more than two years) are fulfilled and if the interests of the general public and of the persons harmed in prosecution are negligible. These provisions apply, by reference, also to the ACL.

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114 Article 50 Paragraph 1 FINMASA.
115 Article 156 Paragraph 1 FMIA.
116 Article 50 Paragraph 1 FINMASA and Article 1 of the SCP.
117 Article 50 Paragraph 2 FINMASA.
118 Article 53 of the Criminal Act.
iv Sentencing and liability

Administrative sanctions

FINMA is given supervisory tools under Article 29 et seq. FINMASA. Among others, FINMA may require information, restore compliance with the law, issue a declaratory ruling, prohibit a person from practising a profession, publish a ruling, confiscate any profit or revoke a licence, withdraw a recognition and cancel a registration.

If the duty to report shareholdings is violated, insider information is misused or the market manipulated, FINMA may issue a declaratory ruling, publish the supervisory ruling or confiscate any profit.119

If shareholdings are not reported, FINMA may, until the duty has been complied with, suspend voting and associated rights and prohibit the person concerned from acquiring further shares or purchase or sale rights relating to shares of the company, be it directly, indirectly or acting in concert with third parties.120

Criminal penalties

A criminal misuse of insider information or market manipulation may result in a penalty of up to 810,000 Swiss francs or imprisonment of up to three years.121 If the profit exceeds 1 million Swiss francs, imprisonment may be up to five years.

Penalties of up to 10 million Swiss francs may be imposed in cases where the duty to disclose shareholdings or the duty to make an offer are wilfully violated.122

Wilfully providing false information or withholding information in a prospectus with respect to collective investment schemes may result in a fine of up to 810,000 Swiss francs or imprisonment for up to three years.123

Articles 89–92 FinSA govern the criminal provisions of FinSA. Of particular relevance is the new criminal offence of Article 90 FinSA. It punishes the intentional violation of FinSA prospectus regulations and key information documents. Accordingly, a fine not exceeding 500,000 Swiss francs is imposed on any person who wilfully provides false information or withholds material facts in the prospectus or key information document. The offence also applies to any person who fails to publish the prospectus or the key information document by the beginning of the public offer at the latest. A reduced fine not exceeding 100,000 Swiss francs is imposed in particular on financial service providers who wilfully fail to make the key information document available prior to subscription or conclusion of the contract.124

It should be noted that the criminal provisions mentioned above do not apply to persons or entities that are subject to the supervision of FINMA, Article 92 FinSA. The rationale behind this exception is that FINMA supervised institutions are already liable under supervisory sanctions so that a threat of criminal offence is not necessary.125

119 Article 145 FMIA.
120 Article 144 FMIA.
121 Article 154 et seq. FMIA.
122 Article 151 et seq. FMIA.
123 Article 148 Paragraph 1 lit. f CISA.
124 Dispatch on FinSA and FinIA (footnote 20), p. 9003.
125 Bohrer/Rehm/ Huggenberger/Spiegel/ Vollenweider (footnote 46), p. 46.
Cooperation between FINMA and prosecution authorities

FINMA and the competent prosecution authority are obliged to exchange the information needed in connection with their collaboration and to fulfil their tasks. They must use the information received exclusively to fulfil their respective tasks and coordinate their investigations to the extent practicable and required.

Where FINMA obtains knowledge of common law felonies and misdemeanours or of offences against a financial market act, it must notify the competent prosecution authorities (Article 38 FINMASA).

IV CROSS-BORDER ISSUES

i Private enforcement

Questions of jurisdiction and of applicable law for international cases are governed in Switzerland mainly by the PILA and the LC. Procedural matters, such as the taking of evidence or the service of judicial documents, may also be subject to international conventions.126

With regard to most European states, the LC governs jurisdiction. The LC does not provide a special provision for securities litigation. In principle, the claimant may choose to sue in the country where the defendant is domiciled,127 or in a special jurisdiction depending on the legal nature of the claim. If the claim concerns contractual matters,128 there is a special jurisdiction at the place of performance. In tort matters, a special jurisdiction at the place where the harmful event occurs or might occur may be relied on.129 Finally, there is a mandatory jurisdiction in favour of consumers.130

The PILA governs, inter alia, the jurisdiction with regard to disputes involving parties from states other than the contracting states of the LC. Similarly to the LC, the PILA provides for the option to sue at the place of the defendant’s residence,131 at a special jurisdiction at the place of performance132 or at the place where the harmful action was executed or the injury resulted.133 Like the LC, the PILA also provides for mandatory consumer jurisdiction.134 Contrary to the LC, the PILA provides for additional special jurisdictions for corporate matters, such as prospectus liability; liability for administration, business management and liquidation; or auditors’ liability. Thus, a claimant may also sue at the courts of the registered office of the concerned company,135 or at the place of issue of the securities.136

The applicable law also depends on the qualification of the legal nature of the respective claim. If the claim qualifies as contractual, in principle, the law of the state applies where

126 For example, the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters or the Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters.
127 Article 2 Paragraph LC.
128 Article 5 Paragraph lit. b LC.
129 Article 5 Paragraph 3 LC.
130 Article 15 LC.
131 Article 2 PILA.
132 Article 113 PILA.
133 Article 129 PILA.
134 Article 114 PILA.
135 Article 151 Paragraph 1 and Paragraph 2 PILA.
136 Article 151 Paragraph 3 PILA. The jurisdiction at the place of issue of securities may not be excluded by a forum clause.
the performance is rendered.\textsuperscript{137} If the investor is considered a consumer, the law at his or her usual place of residence will apply.\textsuperscript{138} If the action is based on tort and the parties have a common habitual residence, the law of that place applies.\textsuperscript{139} Otherwise, the law of the state where the harmful action was taken, or where the harmful event occurred, may apply.\textsuperscript{140}

For liability related to corporate law, the law applying to the concerned company or the law at the place of issue of the securities may apply.\textsuperscript{141}

\section*{ii Public enforcement}

Cross-border issues may arise if a foreign entity violates a financial market act, such as FinSA, FMIA or CISA.

FinSA applies not only to domestic financial service providers but also to foreign financial service providers that offer financial services to clients in Switzerland. FMIA is applicable, among others, to securities listed in Switzerland, irrespective of the domicile of the parties involved. CISA is applicable, among others, to Swiss collective investment schemes and to foreign collective investment schemes that are offered in Switzerland.

In order to enforce the financial market acts against a foreign entity, FINMA may ask foreign financial market supervisory authorities for assistance\textsuperscript{142} or may itself carry out audits of supervised persons and entities abroad or have such audits carried out by audit agents.\textsuperscript{143}

\section*{V YEAR IN REVIEW}

By a judgment of 17 December 2018,\textsuperscript{144} the Swiss Federal Administrative Court decided an appeal against an enforcement decision by FINMA. A company engaged in asset management used funds received from investors for funding a capital increase. The Court confirmed the decision of FINMA to liquidate the company because of non-licensed public acceptance of funds, that is, non-licensed banking activity, and held that the original acceptance of funds qualified as a case of Article 752 CO. The decision underlines the importance of strict compliance of the prospectus with all legal requirements of a bond issue.

A topic of hot debate in recent years was whether initial coin offerings (ICOs) qualify as securities and under which conditions ICOs should be subject to securities regulations.\textsuperscript{145} In February 2018, FINMA published guidelines for enquiries regarding initial coin offers (ICOs).\textsuperscript{146} Accordingly, FINMA classifies the tokens issued as payment, utility and asset tokens. Asset tokens represent assets such as participations in real physical underlyings, companies or earnings streams, or an entitlement to dividends or interest payments. In terms of their economic function, the tokens are analogous to equities, bonds or derivatives. Thus,

\begin{itemize}
\item\textsuperscript{137} Article 116 PILA.
\item\textsuperscript{138} Article 120 PILA.
\item\textsuperscript{139} Article 133 Paragraph 1 PILA.
\item\textsuperscript{140} Article 133 Paragraph 2 PILA.
\item\textsuperscript{141} Article 156 PILA and Article 154 PILA.
\item\textsuperscript{142} Article 42 et seq. FINMASA.
\item\textsuperscript{143} Article 42 Paragraph 1 FINMASA.
\item\textsuperscript{144} Case No. B-117/2018.
\item\textsuperscript{145} Aufsichtsmitteilung 04/2017 of 29 September 2017 by FINMA.
\item\textsuperscript{146} FINMA, Wegleitung für Unterstellungsanfragen betreffend Initial Coin Offerings (ICOs) of 16 February 2018.
\end{itemize}
only asset tokens qualify as securities in the meaning of FinSA. Consequently, if a token qualifies as a security, it is also subject to the prospectus requirement according to FinSA.\textsuperscript{147} However, no related litigation has entailed to date.

\textbf{VI \hspace{1em} OUTLOOK AND CONCLUSIONS}

The question arises whether the new financial market laws will create uniform competitive conditions for financial intermediaries and improve client protection. The regulatory picture is not significantly different, but has gained density and complexity.\textsuperscript{148} Although the controversial class action instruments and the reversal of the burden of proof have been removed from the bill, they will possibly reappear in the revision of the CPC. Nevertheless, FinSA will make it easier for clients to enforce their legal claims against the financial service provider, as private enforcement has been improved by the institution of the ombudsman’s office.\textsuperscript{149} In addition, non-compliance by a bank with a duty of conduct, even if it is not sanctioned from a regulatory point of view, may be the basis for a claim under civil law. It is likely that the statutory right to the provision of documents will also reduce the power imbalance between the financial service provider and client. Transparency is also significantly enhanced by the obligation of the financial service provider to maintain communication to the client. Nevertheless, it remains to be seen whether these changes will actually result in more actions directed at enforcing clients’ rights.

\textsuperscript{147} Bohrer/Rehm/ Huggenberger/Spiegel/ Vollenweider (footnote 46), p. 47.
\textsuperscript{148} Nobel (footnote 7), p. XXXVIII No. 74.
\textsuperscript{149} Bohrer/Rehm/ Huggenberger/Spiegel/ Vollenweider (footnote 46), p. 10.
I OVERVIEW

i Sources of law
The primary source of securities law in Taiwan is the Securities and Exchange Act (the Securities Act), which governs the regulation and supervision of public offering, issuing, and trading of securities. In addition, any matters not provided for in the Securities Act shall be governed by the provision of the Company Act and other relevant acts. Besides such laws, subordinate rules and regulations, such as the Securities Act Enforcement Rules, Regulations Governing the Offering and Issuance of Securities by Securities Issuers and so forth, are promulgated by the competent authority, namely the Financial Supervisory Commission. Moreover, the guidelines and principles established by the self-regulatory associations, such as the Taiwan Stock Exchange Corporation (TWSE) and the Taipei Exchange (TPEx), also play an important role for the regulation and supervision of securities-related activities.

ii Regulatory authorities
The competent authority under the Securities Act is the Financial Supervisory Commission. Administrative dispositions and fines can be imposed by the commission in the event that there is any violation of the Securities Act as provided thereunder. Certain violations of the Securities Act may result in criminal liabilities; and, therefore, the public prosecutors will commence an investigation. If the evidence obtained by the public prosecutor in the course of investigation is sufficient to show that the accused is suspected of having committed an offence, a public prosecution shall be initiated.

iii Common securities claims
Common securities claims in Taiwan include, but are not limited to, insider trading, securities market manipulations, misrepresentations or frauds (for example, financial statement frauds and misrepresentation in a prospectus). Criminal liabilities will be imposed on the individuals who committed such offences. Secondary liabilities may incur to accountants and lawyers as provided in the Securities Act. For example: (1) if a lawyer issues a false or untrue opinion regarding any contract, report or document of the company or foreign company related to securities offering, issuance, or trading; and (2) if an accountant fails to faithfully fulfil his or her audit duties and issues a report or opinion with respect to any material falsehood or
error in a financial report, document, or information reported or published by a company or foreign company; or he or she fails to expressly state a material falsehood or error in a company or foreign company financial report owing to failure to audit in accordance with applicable laws and regulations and generally accepted audit principles, the lawyer or accountant shall be punished with imprisonment for not more than five years, or a fine of not more than NT$15 million may be imposed in lieu thereof or in addition thereto according to Article 174, Paragraph 2, Subparagraphs 1 and 2 of the Securities Act. In addition to criminal liabilities, said lawyers and accountants will be held jointly liable, within the scope of their responsibilities, with the issuer to any bona fide counterpart for damages resulted therefrom. However, because it is not an easy job to identify the scope of the responsibility of a lawyer or accountant and to prove the causation, in practice, investors may find it difficult to successfully claim damages against such lawyers and accountants.

II PRIVATE ENFORCEMENT

i Forms of action

Civil liabilities under the Securities Act

According to Article 20, Paragraph 3 of the Securities Act, in the event that there are any representations, frauds or any other acts that are sufficient to mislead other persons during the public offering, issuing, private placement or trading of securities, the person who did such an action or actions shall be held liable for damage sustained by bona fide purchasers or sellers of the securities.

According to Article 20-1, Paragraph 1 of the Securities Act, when the essential content of the financial reports or any other relevant financial or business documents filed or publicly disclosed by an issuer in accordance with this act contain misrepresentations or non-disclosures, the issuer and its responsible persons, and employees of the issuer who placed their signatures or seals on the financial report or the financial or business document in question, shall bear liability for damage suffered by the bona fide purchasers, sellers or holders of securities issued by the issuer.

According to Article 31, Paragraph 2 of the Securities Act, in the event that a prospectus is not delivered to the subscriber of securities prior to public offering, the violator shall be held liable for the compensation of damage sustained by any bona fide counterpart.

According to Article 32, Paragraph 1 of the Securities Act, in the event that the prospectus for public offering contains false information or omissions in its material contents, the following persons, within the scope of their responsibilities, shall be held jointly liable with the issuer to any bona fide counterpart for damage resulting therefrom: (1) the issuer and its responsible persons; (2) any employee of the issuer who has signed and affixed his or her seal on the prospectus to certify its accuracy in whole or in part; (3) any underwriter with respect to such securities; and (4) any certified public accountant, lawyer, engineer or any professional or technical person who has signed and affixed his or her seal to certify in whole or in part, or to present his or her opinion, on the correctness of the prospectus.

According to Article 155, Paragraph 3 of the Securities Act, the violator shall be held liable to compensate the damage suffered by the bona fide purchasers or sellers of the securities in the event that any of the following actions occur with regard to securities publicly listed on a stock exchange:
a ordering or reporting a trade on a centralised securities exchange market and failing to perform settlement after the transaction is made, where such act is sufficient to affect the market order;

b conspiring with other parties in a scheme such that the first party buys or sells designated securities at an agreed price, while the second party sells or buys from the first party in the same transaction, with the intent to inflate or deflate the trading prices of said securities on the centralised securities exchange market;

c continuously buying at high prices or selling at low prices designated securities for his or her own account or under the names of other parties with the intent to inflate or deflate the trading prices on said securities traded on the centralised securities exchange market, when there is a likelihood that market prices or market order will be affected;

d continuously ordering or reporting a series of trades under one’s own account or under the names of other parties, and completing the corresponding transactions with the intent of creating an impression on the centralised securities exchange market of brisk trading in a particular security;

e spreading rumours or false information with the intent to influence the trading prices of designated securities traded on the centralised securities exchange market; and

f directly or indirectly performing any other manipulative acts to influence the trading prices of securities traded on the centralised securities exchange market.

According to Article 157-1, Paragraphs 1 to 3 of the Securities Act: (1) the director, supervisor, managerial officer of the issuing company or a natural person designated to exercise powers as representative pursuant to Article 27, Paragraph 1 of the Company Act; (2) shareholders holding more than 10 per cent of the shares of the company; (3) any person who has learned the information by reason of occupational or controlling relationship; (4) a person who, though no longer among those listed in one of the preceding three points, has only lost such status within the last six months; and (5) any person who has learned the information from any of the persons named in the preceding four subparagraphs, shall not:

a purchase or sell, in the person’s own name or in the name of another, shares of the company that are listed on an exchange or an over-the-counter market or any other equity-type security of the company, upon his or her actual knowledge of any information that will have a material impact on the price of the securities of the issuing company; or

b sell, in the person’s own name or in the name of another, the non-equity-type corporate bonds of such company that are listed on an exchange or an over-the-counter market, upon his or her actual knowledge of any information that will have a material impact on the ability of the issuing company to pay principal or interest.

The restriction period for the aforementioned transaction is after the information is precise and is prior to the public disclosure of such information or within 18 hours of its public disclosure.

Persons in violation of the above shall be held liable to the trading counterparts who undertook the opposite-side trade with bona fide intent. The court may treble the damages, upon request of the counterpart, or reduce the damages where the violation is minor.

In terms of class action, the Securities Investor and Futures Trader Protection Act was enacted to safeguard the rights and interests of securities investors and futures traders and promote the sound development of the securities and futures markets, under which the
protection institution may submit a matter to arbitration or institute an action in its own
name with respect to a securities or futures matter arising from a single cause that is injurious
to multiple securities investors or futures traders, after having been so empowered by no
fewer than 20 securities investors or futures traders.

As for shareholder derivative actions, shareholders who continuously have held 3 per
cent or more of the total number of the outstanding shares of the company for over one year
shall first request in writing the supervisors of the company to institute, for the company, an
action against a director of the company, and in case the supervisor fails to institute an action
within 30 days of having received the request, then the shareholders filing such request may
institute the action for the company.

ii Procedure
One of the most salient features of a securities claim is that the damage suffered by each of
the investors may be small but there are thousands of people affected by a single cause. It is
very difficult, and costs a lot, for an individual to bring civil action against big companies,
and investors may reside in different parts of the country, which makes it troublesome for
them to file a lawsuit before the court where the company is located. Therefore, in Taiwan
the protection institution may institute an action in its own name with respect to a securities
or futures matter arising from a single cause that is injurious to multiple securities investors
or futures traders, after having been so empowered by no fewer than 20 securities investors
or futures traders.

There is no discovery in Taiwan, which makes it difficult for the plaintiffs to collect
evidence. To ease the burden of proof, a statutory presumption of fault is provided under the
Securities Act, and for this kind of liability, it will be the defendant who shall bear the burden
of proof that he or she has exercised reasonable care.

iii Settlements
Settlements of securities actions do not have special regulation under Taiwanese law, unless
the action is brought by the protection institution and the securities investors specifically
restrict the institution’s power to enter into a settlement. Judicial review for settlement in a
civil proceeding is minimal; in practice, the court will only review the enforceability of the
terms of the settlement.

iv Damages and remedies
The remedies that investors may seek include compensation for the injuries actually suffered
and the interest that has been lost. For insider trading, Article 157-1 of the Securities Act
specifically stipulates the calculation of damages that shall be the amount of the difference
between the buy or sell price and the average closing price for 10 business days after the date
of public disclosure. In addition, the court may also, upon the request of the counterpart
trading in good faith, treble the damages payable by the violators should the violation be
of a severe nature; while the court may, on the other hand, reduce the damages where the
violation is minor.
III PUBLIC ENFORCEMENT

i Forms of action

Supervision

Under the Securities Act, the Financial Supervisory Commission has the power to conduct supervision on public companies.

For example, a company shall file with the Financial Supervisory Commission and announce to the public the class and numbers of the shares held by its directors, supervisors, managerial officers and shareholders holding more than 10 per cent of the total shares of the company. The total shares of nominal stocks held by the entire body of either directors or supervisors of an issuer shall not be less than a certain percentage of its total issued shares, which varies depending on the paid-in capital of the company.

Furthermore, the transfer of stocks by said persons shall be effected in accordance with any of the following methods: (1) an offering to the public following approval from or an effective registration with the Financial Supervisory Commission; (2) to transfer, at least three days following registration with the Financial Supervisory Commission, on a centralised exchange market or an over-the-counter market, shares that have satisfied the holding period requirement and within the daily transfer allowance ratio prescribed by the Financial Supervisory Commission;4 and (3) to transfer, within three days following registration with the Financial Supervisory Commission, by means of private placement to designated persons satisfying the qualifications prescribed by the Financial Supervisory Commission.

Administrative fines will be imposed by the Financial Supervisory Commission if there is any violation of the above requirements.

Inspection

In order to protect public interests and the interests of investors, the Financial Supervisory Commission may, before the approval of a public offer or issuance, require the issuer, securities underwriters, or other related parties to submit reference materials or reports, or make a direct examination of relevant documents and accounts. After the issuance of securities, the Financial Supervisory Commission may, at any time, order the issuer to submit financial and business reports or makes a direct examination of the financial and business conditions of the issuer.

During the aforementioned examination, the Financial Supervisory Commission may issue a corrective order, or it may additionally impose penalties pursuant to the Securities Act if it finds that the issuer has failed to comply with an act or regulation.

The Financial Supervisory Commission will collaborate with the public prosecutor’s office in the event suspicious criminal offences are discovered from its examination of the reports, direct inspection or investigation or by any other means.

Under the Securities Act, most of the possible criminal liabilities are severe, and therefore, the public prosecutor may not have the discretion to make a ruling to render a deferred prosecution by setting up a period not more than three years and not less than one year according to Article 253-1 of the Code of Criminal Procedure. Moreover, ‘materiality’ is not an element of certain securities-related crimes, for example misrepresentation in financial statement; that is to say, any immaterial offence may still trigger criminal prosecution and the following time-consuming criminal proceeding. Directors and the management team of

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4 This registration requirement shall not apply to transfers totalling less than 10,000 shares per exchange day.
a public company, including the company itself, will be trapped in the criminal proceeding even if there is just one minor mistake in the financial report. What the law provides leaves little or even no room for the public prosecutor to make a more ‘appropriate’ disposition and sometimes the criminal prosecution or proceeding itself further deteriorates the management of the company and it is the investors who will suffer therefrom, eventually. This was not the original purpose of the enactment of the Securities Act. Notably, in 2017 there was a case involving financial statement misrepresentation, and the district prosecutor’s office decided to render a deferred prosecution considering there was no damage incurred to the company. This decision was later overruled by the Taiwan High Prosecutors Office, and the district prosecutor’s office, after further investigation, decided to initiate prosecution.

ii Procedure
In terms of the criminal proceeding against securities-related offenders, some of the difficulties faced in Taiwan are highlighted below.

Difficulties in collection of evidence
Most of the major financial crimes have the following common characteristics: they are conducted internally in secrecy, and covered by or disguised as legal actions. It would be very difficult for the law enforcer, as an outsider, to uncover all the hidden facts. Especially in relation to cross-border transactions, the Taiwanese government, subject to its political status in international society, has limited access to judicial assistance from other jurisdictions.

Difficulties in tracing overseas cash flow, seizure of criminal proceeds and extradition
Again, owing to the fact that Taiwan’s position in the world is still ‘ambiguous’, even when the criminals are finally convicted, if the proceeds were hidden overseas, it is difficult to recover and confiscate such proceeds of crime. In addition, if the accused flees the country, in most cases to mainland China, without formal extradition, prosecution cannot proceed and justice cannot be achieved.

Lack of discretion for the prosecutor
As mentioned above, although the law provides systems such as deferred prosecution and bargaining process, the application is limited, primarily for misdemeanours. Public prosecutors do not have the discretion, nor gain leverage to extract guilty pleas from defendants and to reduce the number of cases that go to the court.

iii Settlements
Deferred prosecution
According to Article 253-1, Paragraph 1 of the Code of Criminal Procedure, if an accused has committed an offence other than those punishable with the death penalty, life imprisonment, or a minimum term of imprisonment of not less than three years, the public prosecutor, after considering the matters specified in Article 57 of the Criminal Code and the maintenance and protection of public interest, deems that a deferred prosecution is appropriate, he or she may make a ruling to render a deferred prosecution by setting up a period of between one and three years, starting from the date the ruling of deferred prosecution is finalised. A public prosecutor when making a ruling on deferred prosecution may require the defendant to comply with or perform the following items within a limited period of time: (1) apologise to
the victim; (2) make a written statement of repentance; (3) pay the victim an appropriate sum as compensation for property or non-property damage; (4) pay a certain sum to a governmental account or a designated non-profit or local self-governing organisation; (5) perform 40 to 240 hours of community services to a designated non-profit, local self-governing organisation, or community; (6) complete drug addiction treatment, psychotherapy and counselling, or other appropriate treatments; (7) comply with the necessary order for the protection of the victim’s safety; or (8) comply with the necessary order for the prevention of recommitting the offence. Before a public prosecutor can order the defendant to comply or perform the acts specified in items (3) to (6), the defendant’s consent shall be obtained; items (3) and (4) may also constitute a ground for civil compulsory enforcement.

**Bargaining process**

Except for those who have committed an offence that is punishable with a sentence of capital punishment, life imprisonment or more than three years’ imprisonment, or is adjudicated by the court of appeal as the court of first instance, once a case has been prosecuted by a prosecutor or applied for a summary judgment, after consulting with the victim’s opinion, the prosecutor may, before the close of oral arguments in the court of first instance or before the summary judgment, act on his or her own discretion or upon requests by the defendant, his or her agent or attorney that has been approved by the court, to negotiate the following items outside the trial procedure. Once both parties involved reach an agreement and the defendant pleads guilty, the prosecutor may request the court to make judgment pursuant to the bargaining process: (1) the defendant accepts the scope of sentence or accepts the sentence to be placed under probation; (2) the defendant shall apologise to the victim; (3) the defendant shall pay a certain amount of compensation; and (4) the defendant shall pay a certain amount to the government treasury, designated public interest organisations, or local autonomous organisations. The prosecutor shall obtain the victim’s consent before negotiating with the defendant on items listed in items (2) or (3).

**iv Sentencing and liability**

A person who has committed any of the offences stipulated in the Securities Act shall be punished with one or more of imprisonment for certain period of time, detention and a fine, depending on what the law provides. Factors that may aggravate the punishment include, for example: (1) the property or property interest obtained from the commission of an offence under Article 171, Paragraph 1 of the Securities Act equals NT$100 million or more; (2) where the property or property interest obtained from commission of an offence under Article 171, Paragraph 1 or 2 of the Securities Act exceeds the maximum amount of the criminal fine, the fine may be increased within the scope of the property or property interest obtained; and (3) if the stability of the securities market is harmed, the punishment shall be increased by half. As for factors that may mitigate the punishment, punishment can be reduced if: (1) a person who commits an offence and subsequently voluntarily surrenders him or herself and hands over the proceeds of crime in full; (2) a person who commits an offence and confesses during the prosecutorial investigation and he or she voluntarily hands over the proceeds of crime in full, and where another principal offender or an accomplice is captured as a result, the punishment shall be reduced by half; and (3) for the making of false statements in the content of a financial report by a managerial officer or accounting officer who signs or seals the financial report, the punishment may be reduced or remitted if the person has
submitted a corrective opinion and provided evidence in a report to the Financial Supervisory Commission before it or a judicial agency has commenced an investigation *ex officio* or upon a complaint filed by another person.

In addition to criminal liabilities, the Financial Supervisory Commission may impose administrative fines, within the range as provided in the Securities Act where applicable, on the violators as well.

IV CROSS-BORDER ISSUES

i Regulations on foreign issuers

To manage and supervise the public offering, issuance, private placement and trading of the securities issued by a foreign company that has been approved, in Taiwan, by the stock exchange or over-the-counter securities exchange for listed trading on the stock exchange or over-the-counter market, or for registration as emerging stock, the Securities Act shall apply *mutatis mutandis*. Different sets of rules will apply depending on whether the foreign company's stock is traded on a foreign securities exchange or not. Foreign traded companies are less regulated, as such companies are subject to the supervision of a foreign securities competent authority.

In addition, a foreign company shall designate a representative in Taiwan to represent the company in litigious and non-litigious matters under the Securities Act, and to serve as its responsible person under that Act in Taiwan. The representative shall have a domicile or residence in Taiwan. The foreign company shall file the name, domicile or residence, and power of attorney of its representative with the Financial Supervisory Commission, and shall update this information in the event of any changes.

ii Jurisdiction issues

A foreign issuer should specify in its articles of incorporation or organisational documents that matters in connection with protection of shareholder equity are subject to the jurisdiction of Taiwanese courts.

However, when the laws and regulations of a foreign issuer's country of registration explicitly provide that important matters in connection with protection of shareholder equity are subject to mandatory provisions regarding exclusive jurisdiction of a foreign court, so that Taiwanese courts cannot be adopted as part of its articles of incorporation or organisational documents, this shall be disclosed in the prospectus, and it shall have no less than two directors (including the independent directors) who are domiciled in Taiwan.

V YEAR IN REVIEW

The latest amendment to the Securities Act was adopted on 21 June 2019, which requires the management team, including the chairperson of the board, the managerial officer and accounting officer, to sign or stamp on the financial reports, in order to improve the internal managing process of a company.
VI OUTLOOK AND CONCLUSIONS

One of the important pieces of pending legislation is the proposal to enhance independent directors’ exercise of their power to monitor public company management, by prohibiting the company or other board members from hindering, refusing or evading the performance of duty conducted by the independent directors. However, the reality is that independent directors are elected by the majority of shareholders, as are other board members, and if the company is still controlled by such a majority, no matter what powers are vested in the independent directors, it may not be practical to expect their full independence.
I OVERVIEW

i Sources of law

The foundation of securities law in the United States is a series of New Deal-era federal statutes enacted between 1933 and 1940. Securities regulation in the United States had traditionally been left to the individual states. But the stock market crash of 1929 and the ensuing depression persuaded Congress that federal legislation was necessary to restore investor confidence in securities markets. Congress thus enacted the Securities Act of 1933 (the Securities Act), which generally regulates the issuance of new securities, and the Securities Exchange Act of 1934 (the Exchange Act), which generally regulates secondary trading of securities after they are issued. Since their enactment, the Securities Act and the Exchange Act have been the bedrock of securities regulation in the United States.

These foundational statutes were soon supplemented by additional federal laws designed to fill out the regulatory framework: the Commodity Exchange Act of 1936, the Trust Indenture Act of 1939, the Investment Company Act of 1940 and the Investment Advisers Act of 1940. In addition to establishing general rules governing disclosure in securities trading, these statutes created a number of federal administrative agencies, including most prominently the Securities and Exchange Commission (SEC), empowered to announce rules that interpret and provide for the enforcement of the federal securities statutes. These regulatory agencies are supplemented in turn by self-regulatory organisations, including the Financial Industry Regulatory Authority (FINRA) and the various securities exchanges, which issue their own rules and police their membership under the oversight of the SEC. Finally, judicial decisions interpreting the securities laws and regulations are an important source of securities law in the United States.

Over the past three decades, Congress has augmented this federal regulatory scheme through new legislation, including, most importantly:

a the Private Securities Litigation Reform Act of 1995 (PSLRA), which amended the Securities Act and the Exchange Act with the objective of reducing the incidence of meritless private securities litigation;

b the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which further amended the Securities Act and the Exchange Act to ensure that securities litigation would be channelled to the federal courts;

1 William Savitt is a partner and Noah B Yavitz is an associate at Wachtell, Lipton, Rosen & Katz.
the Commodity Futures Modernization Act of 2000, which revamped the Commodity Exchange Act of 1936 with a particular focus on strengthening regulation of the futures market and relaxing oversight of swap agreements;

d the Sarbanes-Oxley Act of 2002, which sought to enhance public disclosure, improve the quality and transparency of financial reporting and auditing, and strengthen penalties for securities law violations;

e the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), which increased exposure to liability under the federal securities laws of credit-ratings agencies and expanded the SEC’s power to pursue enforcement actions premised on knowingly or recklessly aiding or abetting violations of the Securities Act, the Investment Company Act and the Investment Advisers Act; and

f the Jumpstart Our Business Startups Act of 2012, which instructed the SEC to write rules governing capital formation, disclosure and registration requirements.

The full effect of this second wave of federal securities legislation continues to reverberate through the American legal system, as the agencies charged with establishing regulations under Dodd-Frank put the final touches to their implementation of the statutes and the federal courts interpret their provisions. Moreover, federal elections in the United States have led to further uncertainty, raising the likelihood – as yet unrealised – that recent legislation and rule-making may be revisited or extended as power transfers between parties with strikingly different approaches to securities regulation. What is certain is that the legislation of the past several decades will continue to alter the scope and character of securities law in the United States.

In addition to these federal sources of law, state laws continue to regulate the securities markets (often called blue sky laws), and state corporate law has created a fiduciary duty of candour that often imposes disclosure obligations similar to federal law.

ii Regulatory authorities

American securities law is enforced by government agencies, self-regulatory organisations and private litigation. While the SEC is empowered to pursue civil enforcement actions, all criminal actions under the federal securities laws are prosecuted by the United States Department of Justice. Self-regulatory organisations such as FINRA and the securities exchanges have more limited enforcement powers; they can fine, suspend or bar their members from participating in certain aspects of the securities industry. Private litigants can sometimes avail themselves of state and federal statutes to seek monetary damages and occasionally injunctive relief.

Most civil enforcement actions – that is, lawsuits brought by the government to enforce the law or by investors to recover damages under the law – can be brought only in the federal courts. Government agencies such as the SEC can also bring administrative proceedings, which are presided over by administrative law judges. Criminal prosecutions proceed through the court system.

Self-regulatory organisations enforce their rules by pursuing formal complaints before internal adjudicators. For example, formal complaints filed by FINRA are presented before FINRA’s Office of Hearing Officers. The determinations of this Office can be appealed before FINRA’s National Adjudicatory Council, the determinations of which can in turn be reviewed by the SEC and then the federal courts.
Common securities claims

The most common securities claims under US law seek to enforce rights under Sections 11, 12 and 17 of the Securities Act and Sections 10, 13 and 14 of the Exchange Act. Monetary damages are available under each of these provisions for civil violations. Criminal penalties are generally available where an individual or corporation ‘wilfully’ violates the provisions of the Securities Act or the Exchange Act.

Sections 11 and 12 of the Securities Act provide buyers a cause of action to recover for violations of the mandatory disclosure rules governing prospectuses and registration statements: Section 11 makes issuers responsible for a false or misleading registration statement liable in damages to any and all purchasers regardless of whom they bought from, while Section 12 allows a purchaser to rescind his or her purchase of securities, or to recover damages from the issuer if the purchaser no longer holds the stock, provided that the seller used a false or misleading prospectus or statement in making the sale. Section 17 is the general anti-fraud provision of the Securities Act, governing all sales by an issuer and prohibiting practices that would defraud a purchaser of securities.

Section 10 of the Exchange Act empowers the SEC to issue regulations restricting short sales, stop-loss orders and the use of manipulative or deceptive devices in the purchase or sale of securities. The SEC has promulgated a large number of rules under Section 10, the most important of which is Rule 10b-5, which is patterned closely on Section 17 of the Securities Act and generally prohibits fraud in the exchange of securities. Rule 10b-5 is by far the most important civil liability provision of the securities law. A significant percentage of US private securities actions seek damages under Rule 10b-5 and the US regulation of insider trading is largely rooted in the application of that rule.

Section 13 of the Exchange Act imposes reporting requirements on issuers, large institutional investment managers and shareholders who acquire a greater than 5 per cent stake in a security. Under Regulation 13D, a report must be made to the SEC within 10 days of the 5 per cent threshold being crossed.

Section 14(a) and (b) empower the SEC to regulate the solicitation of voting proxies from shareholders. Among the rules the SEC has issued under this authority is Rule 14a-9, which prohibits solicitation via false or misleading proxies. Section 14(d), as implemented in Regulation 14D, regulates and requires disclosure in connection with tender offers by bidders seeking to own more than 5 per cent of a publicly traded security. Section 14(e) and Rule 14e-3 broadly prohibit fraud in connection with the making of tender offers – a prohibition that extends to circumstances in which offerors tip friendly co-investors.

Secondary liability for securities law violations is also possible in some circumstances. A defendant can be held answerable for another person’s primary violations of the securities laws under Section 15 of the Securities Act or Section 20 of the Exchange Act, as well as by application of the common law doctrines of respondent superior, aiding and abetting or conspiracy. Section 15 imposes secondary liability on controlling persons for primary liability of ‘controlled persons’ under Sections 11 and 12 (but not 17) of the Securities Act. Section 20 imposes secondary liability on controlling persons for primary liabilities of controlled
persons under any provision of the Exchange Act. Administrative regulations define control, in related contexts, as ‘the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise’, but exactly who meets this standard has never been completely clear. Controlling shareholders, directors and even lenders can be controlling persons, where they have the power or potential power to influence the activities of the controlled person.

Up until the 1994 decision of the Supreme Court in Central Bank of Denver, a majority of US courts had held that civil liability could be imposed on those who aided and abetted primary violations of the securities laws. Central Bank swept away these precedents when it held that Section 10(b) of the Exchange Act would not support a cause of action for aiding and abetting. Moreover, the Court suggested that aiding and abetting liability is unavailable under any of the liability provisions of the Acts.

Following Central Bank, lower federal courts grappled with whether parties, such as accountants and lawyers, traditionally subject to liability under an aiding and abetting theory may be made subject to primary liability for their role in preparing misleading information. In some federal circuits, notably the Ninth, preparatory liability of this kind was held to attach even if a misstatement was made by another party. But throughout much of the country, courts have restricted this preparatory liability. The majority of courts have held that, under Central Bank, a third party may not be held liable by virtue of its participation in the preparation of a misrepresentation; rather, the party must actually make a false or misleading statement to be liable.

In the years since Central Bank, the Supreme Court has twice extended its holding, though this past term the Court issued a decision suggesting a marked expansion of liability for more peripheral participants in fraudulent schemes. In its 2011 Janus Capital Group opinion, the Court held that Rule 10b-5(b) liability may only be imposed on the ‘maker’ of the statement alleged to be materially false or misleading. Three years earlier, in Stoneridge Investment Partners, the Court rejected a theory of ‘scheme’ liability under which plaintiffs brought Rule 10b-5 actions against secondary actors, such as investments banks, that had no duty to disclose and did not prepare or participate in preparing a corporation’s financial misstatements. Most recently, however, the Court has signalled a major departure from Janus Capital and Stoneridge Investment Partners, holding that defendants who merely ‘use’ misstatements may be held liable under other subsections of Rule 10b-5. That decision, Lorenzo v. SEC, could well herald an expansion of ‘scheme’ liability, although the first crop of decisions from the federal courts has taken a mixed stance on that broad interpretation.

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3 17 C.F.R. Section 230.405.
5 Janus Capital Grp, Inc v. First Derivatives Traders, 564 U.S. 135, 142–43 (2011). See In re Pfizer Sec Litig, 819 F.3d 642 (2d Cir. 2016) (finding a genuine dispute of material fact over whether a defendant was the ‘maker’ of allegedly misleading statements by a party in privity, where defendants had final approval over the statements at issue).
7 139 S. Ct. 1094 (2019).
8 See, for example, Malouf v. Sec. & Exch. Comm’n, 933 F.3d 1248, 1259 (10th Cir. 2019), cert. denied, No. 19-909 (U.S. Mar. 9, 2020) (reading Lorenzo expansively to affirm finding that employee was liable under Rule 10b-5(a) and (c) for knowingly failing to correct misstatements and omissions in employer’s public disclosures); Geoffrey A. Orley Revocable Tr. U/AID 1/26/2000 v. Genovese, 2020 WL 611506, at
Importantly, these restrictions on aiding-and-abetting liability do not apply to SEC civil enforcement actions. To the contrary, the PSLRA created a new Section 20(e) of the Exchange Act, which expressly authorised the SEC to seek injunctions or civil monetary penalties from those who knowingly aid or abet primary violations. Liability under Section 20(e) was broadened by Dodd-Frank, which also created a parallel Section 15(b) of the Securities Act. As currently written, Sections 20(e) and 15(b) allow the SEC to pursue actions against parties who knowingly or recklessly aid and abet another party’s violation of the securities laws.

II PRIVATE ENFORCEMENT

i Forms of action

Nearly all private US securities enforcement is through class-action litigation in the federal courts. Where a corporation is itself the entity that suffered injury under the securities laws, derivative actions can be pursued. This litigation is usually ‘lawyer-driven’, relying on plaintiffs’ lawyers to enforce the rights of absent class members. Class-action lawyers typically derive their fees from settlements, or through recovery obtained at the end of the action.

Most private securities class actions are brought under Sections 11 and 12 of the Securities Act and Sections 10 and 14 of the Exchange Act – with Section 14 claims gaining increasing prominence over the past three years, as merger-related litigation has shifted from state to federal courts. Plaintiffs’ burden of proof and the defences available to a defendant will vary depending on which statutory provision is invoked. These provisions can also be civilly enforced by the public authorities, or support criminal prosecution if a violation was willful.

One notable impediment to private claimants seeking remedies under the US securities laws is the frequent absence of a private right to sue. While the right for individual buyers and sellers to bring suit to recover actual losses is well established for claims of fraud under Section 10 of the Exchange Act and some other statutory provisions, it should not be assumed that private plaintiffs can sue to redress conduct that violated the securities laws. In recent years, federal courts have been generally unwilling to imply new private rights of action where Congress has not explicitly provided one – a trend that is unlikely to subside following the appointment of conservative jurists by the current presidential administration. As such, certain areas of enforcement are exclusively in the hands of government authorities.

An additional barrier that plaintiffs must surmount is the need to show standing to sue. The contours of the standing requirement vary from one statutory provision to the next, but in general a plaintiff must show that he or she is the type of party who is authorised to sue under the statute. For example, the Supreme Court has held that to bring an action under Rule 10b-5, a plaintiff must show that he or she purchased or sold securities in the

*8 (S.D.N.Y. Feb. 7, 2020) (adopting a narrowing interpretation of Lorenzo, in an effort to resist an interpretation that would ‘serve to erase the distinction between primary liability . . . and secondary liability . . . ‘); In re Longfin Corp. Sec. Class Action Litig., 2019 WL 1569792, at *8 (S.D.N.Y. Apr. 11, 2019) (citing Lorenzo in holding that a defendant could ‘be liable regardless of whether it “made” any misrepresentations or omissions’); EnSource Investments LLC v. Willis, 2019 WL 6700403, at *13 (S.D. Cal. Dec. 6, 2019) (Lorenzo inapplicable because defendants had not ‘disseminated any false statements’).
transaction complained of. These standing requirements are reviewed where relevant in the discussion below. Note, however, that these obstacles to suit – standing and a private right of action – do not apply to the Securities and Exchange Commission, which can bring an action on behalf of the government under all provisions of the securities laws.

Because the federal securities laws are generally disclosure-based (rather than contract-based), a complaining plaintiff will usually bear the burden of establishing that an issuer, seller, or buyer traded securities on the basis of a material misstatement or omission. Indeed, the requirement that any misstatement be material recurs throughout US securities law and applies to most private and government enforcement actions. The leading case on materiality is *TSC Industries, Inc v. Northway, Inc*,10 in which the Supreme Court defined a material fact as one to which there is a substantial likelihood that a reasonable investor would attach importance in making a decision because the fact would significantly alter the ‘total mix’ of available information.11 In a recent demonstration of how broadly this definition can sweep, the Second Circuit held that a misrepresentation as to price could be found material even in a negotiating context where such misleading statements were common.12 However, some courts have held that false statements or omissions are not materially misleading as long as the market possessed the correct information.13 Additionally, courts have held that actionable statements must be sufficiently ‘concrete’ and ‘specific’, as opposed to ‘single, vague statement[s] that are essentially mere puffery’.14 For example, the Second Circuit recently held that where a defendant insurance company had been cited for non-compliance with certain healthcare regulations, prior public statements about its commitment to behave ethically and comply with applicable regulations were ‘too general to cause a reasonable investor to rely upon them’.15

Under SLUSA, plaintiffs are barred from bringing class actions asserting certain securities fraud claims under state law. Specifically, SLUSA bars state-law claims alleging ‘a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security’.16 This provision of SLUSA was enacted to block plaintiffs from using


11 Ibid. at 449 (defining ‘material’ in the context of Section 14 of the Exchange Act). The definition is now nearly universally applied under all securities liability provisions.

12 United States v. Litvak, 808 F.3d 160, 176 (2d Cir. 2015).

13 See, e.g., *In re Convergent Techs Sec Litig*, 948 F.2d 507 (9th Cir. 1991).

14 *In re N Telecom Ltd Sec Litig*, 116 F. Supp. 2d 446, 466 (S.D.N.Y. 2000) (alteration in the original and internal quotation marks omitted).

15 *Singh v. Cigna Corp*, 918 F.3d 57, 63 (2d Cir. 2019). See also ibid. at 60 (critiquing the complaint as ‘a creative attempt to recast corporate mismanagement as securities fraud’ that failed because ‘generic statements do not invite reasonable reliance by investors’); *Retail Wholesale & Dep’t Store Union Local 338 Ret Fund v. Hewlett-Packard Co*, 845 F.3d 1268, 1275–77 (9th Cir. 2017) (corporate code of conduct ‘inherently aspirational’ and unable to support a securities fraud claim); *In re Rockwell Med, Inc Sec Litig*, 2018 WL 1725553, at *7 (S.D.N.Y. 30 March 2018) (optimistic statements about a product’s ‘imminent success’ not actionable).

state law to evade the PSLRA’s restrictions on federal securities class actions. To effect that purpose, the Supreme Court has interpreted the provision broadly to apply to any alleged misrepresentation that ‘coincides with a securities transaction – whether by the plaintiff or by someone else’.\(^\text{17}\) Despite this guidance, the courts have long struggled with delineating precisely which state-law class actions involving securities are precluded by SLUSA. This has resulted in a framework that varies somewhat from one federal circuit to the next, although in recent years, the Second and Ninth Circuits – whose courts are prime venues for federal securities litigation – have held that SLUSA precludes state-law claims that can succeed only through proof of conduct that is specified in the SLUSA preclusion statute (i.e., misrepresentations or omissions of material fact in connection with the purchase or sale of a covered security).\(^\text{18}\)

Notably, while SLUSA restricts plaintiffs’ ability to circumvent federal law, the Supreme Court recently held in *Cyan Inc v. Beaver County Employees’ Retirement Fund*\(^\text{19}\) that the statute does not restrict plaintiffs from pursuing Securities Act class actions in the state courts. In addition, the *Cyan* Court held that defendants may not remove Securities Act class actions to federal court. *Cyan* thus preserves plaintiffs’ ability to pursue Securities Act class actions outside the federal forum. The decision has spawned a boom in litigation pressing federal securities claims in the state courts, particularly in New York and California. This in turn has given way to significant questions around whether and how to import federal procedural restrictions on security litigation into the state forums. For example, the New York state courts are presently divided over whether the PSLRA’s discovery stay applies in state court.\(^\text{20}\)

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\(^{17}\) *Merrill Lynch, Pierce, Fenner & Smith Inc v. Dabit*, 547 U.S. 71 (2006). In 2014, the Supreme Court clarified that SLUSA preclusion does not extend to misrepresentations involving securities that are not traded on a national exchange, but that were claimed to have been backed by exchange-traded securities. See *Chadbourne & Parke LLP v. Troice*, 571 U.S. 377 (2014).

\(^{18}\) *See In re Kingate Management Ltd Litig*, 784 F.3d 128 (2d Cir. 2015) (to be precluded by SLUSA, allegations must be ‘necessary to’ or ‘form the basis of’ a plaintiff’s state-law claims, although the allegations need not be ‘essential’ to the state-law claims); *Freeman Investments, LP v. Pacific Life Ins Co*, 704 F.3d 1110 (9th Cir. 2013). The Third and Seventh Circuits apply broadly similar standards, see *LaSala v. Bordier et Cie*, 519 F.3d 121, 141 (3d Cir. 2008) (dismissal is warranted where proof of a material misstatement or omission is either a necessary element of the cause of action or otherwise critical to a plaintiff’s success in the case); *Holitz v. JP Morgan Chase Bank, NA*, 846 F.3d 928 (7th Cir. 2017). The Sixth and Eighth Circuits have adopted a somewhat different approach, precluding any complaint that features allegations of misrepresentations in connection with the purchase or sale of securities, while scrutinising other complaints for ‘artful pleading’ to avoid such allegations. See *Segal v. Fifth Third Bank, NA*, 581 F.3d 305, 311 (6th Cir. 2009); *Zola v. TD Ameritrade, Inc*, 889 F.3d 920, 924 (8th Cir. 2018). However, there is disagreement among the federal courts as to whether these standards actually differ. See *In re Kingate*, 784 F.3d at 144–45 (distinguishing the Third Circuit’s standard); *Goldberg v. Bank of America, NA*, 846 F.3d 913, 925 (7th Cir. 2017) (Hamilton, J, dissenting) (describing a ‘three- or four-way’ division of authority among the Second/Ninth, Sixth, Holitz and the Seventh Circuit’s prior decision in *Brown v. Calamos*, 664 F.3d 123, 127 (7th Cir. 2011)); *Northstar Fin Advisors, Inc v. Schwab Investments*, 904 F.3d 821, 830 (9th Cir. 2018) (concluding that the law of SLUSA preclusion ‘appears to be uniform across the circuits’, over a dissenting opinion).

\(^{19}\) 138 S. Ct. 1061 (2018).

Securities Act: Section 11

To bring a securities claim under Section 11(a) of the Securities Act, a plaintiff must show that a registration statement ‘contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading’.21 Once a plaintiff satisfies this burden, Section 11(a) makes liable the issuer, the directors of the issuer, anyone named in the registration statement as about to become a director of the issuer, every person who signed the registration statement, every expert (e.g., accountant or appraiser) who was named as having certified or prepared the misleading part of the registration statement and every underwriter of the security. The plaintiff need not show that he or she relied upon the misstatements or that any defendant acted in bad faith.

Several courts have held that to establish standing, a Section 11 plaintiff must ‘plead that [his or her] stock was issued pursuant to the public offering[s] alleged to be defective’.22 However, most courts have held that stock purchased in a secondary market is ‘issued pursuant to the public offering’ if the plaintiffs can trace their securities to the challenged registration.23

An issuer has virtually no defence under Section 11; it is effectively strictly liable for material misstatements and omissions in registration statements. Assuming a material misstatement, an issuer’s only hope of avoiding liability is to prove that the plaintiff knew of the misstatements or omissions when the trade occurred. However, other defendants have a variety of defences under Section 11(b). Thus, a party named in a registration statement can avoid liability if he or she resigns and informs the SEC of the false or misleading statement before the registration statement becomes effective. In addition, under Section 11(b)(3), a non-issuer defendant can avoid liability if he or she can show reasonable grounds for believing that the alleged misstatements were true. The degree of investigation sufficient to serve as ‘reasonable grounds’ varies by category of defendant – while accountants are largely governed by professional standards, underwriters are subject to much stricter due diligence obligations.24

In Omnicare, Inc v. Laborers District Council Construction Industry Pension Fund,25 the Supreme Court rejected a lower court holding that an issuer’s sincerely held opinion could constitute an ‘untrue statement of a material fact’ under Section 11. The Court reasoned that accurately disclosing a belief cannot amount to an untrue statement. But the Court also held that some genuinely held opinions could still be actionable, because Section 11 also proscribes statements that have ‘omitted to state a material fact . . . necessary to make statements not misleading’. Omitted facts could render a genuinely held opinion misleading where investors expect that the opinion ‘fairly aligns with the information in the issuer’s possession at the

23 See In re Ariad Pharm, Inc Sec Litig, 842 F.3d 744, 756 (1st Cir. 2016); DeMaria v. Andersen, 318 F.3d 170, 178 (2d Cir. 2003); In re Supreme Specialties, Inc Sec Litig, 438 F.3d 256, 274 n. 7 (3d Cir. 2006); Rosenzweig v. Azurix Corp, 332 F.3d 854, 871–73 (5th Cir. 2003); Lee v. Ernst & Young, LLP, 294 F.3d 969 (8th Cir. 2002); In re Century Aluminum Co Sec Litig, 729 F.3d 1104, 1106 (9th Cir. 2013); Joseph v. Wiles, 223 F.3d 1155, 1159–61 (10th Cir. 2000).
24 Notably, an underwriter typically cannot rely on indemnification to shift its liability to an issuer. See, for example, Perry v. Duoyan Printing, Inc, 232 F. Supp. 3d 589, 593–95 (S.D.N.Y. 2017) (holding that public policy prohibits indemnity for defendants found to have ‘committed a sin graver than ordinary negligence’).
time’. Accordingly, ‘if a registration statement omits material facts about the issuer’s inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from [the issuer’s statement of opinion], then Section 11’s omissions clause creates liability’. The Court counselled that ‘to avoid exposure for omissions under Section 11, an issuer need only divulge an opinion’s basis, or else make clear the real tentativeness of its belief’. In applying Omnicare, the Second Circuit has held that a securities claim may fail even where defendants were aware of significant information that undermined their public statements.26 Significantly, the principles of Omnicare have gained purchase on other areas of federal securities law, including claims brought under Section 10(b) of the Exchange Act.27

**Securities Act: Section 12**

Under Section 12(a)(1), any person who offers or sells a security required to be registered under the Securities Act but not registered is liable to the person purchasing the security. Under Section 12(a)(2), any person who by the use of any means of interstate commerce offers or sells a security on the basis of a materially false or misleading prospectus or materially false or misleading oral statements is liable to the person purchasing from him or her, unless he or she can show that he or she did not know, and could not in the exercise of reasonable care have known, of the falsehood or omission.

To succeed in a Section 12 claim, a plaintiff need not show that he or she relied on the misstatements or that the defendant acted in bad faith. However, no liability will attach in a private action – under Section 12 or other provisions of the Securities Act or the Exchange Act – based on certain statutorily defined ‘forward-looking statements’ unless the plaintiff proves actual knowledge of the false or misleading nature of the statement on the part of a natural person making the statement or on the part of an executive officer approving the statement made on behalf of a business entity.28 In addition, a defendant can avoid Section 12(a)(2) liability by showing that any claimed depreciation in a security’s value was not caused by the defendant’s misstatements or omissions.29

**Exchange Act: Section 10**

Section 10 authorises the SEC to prescribe rules addressing prohibited securities trading practices. Under Section 10(a), the SEC is empowered to prohibit short sales and the use of stop-loss orders for securities registered under the Exchange Act or traded on national security exchanges. The statute also empowers the SEC to prohibit ‘the use of a manipulative or deceptive device or contrivance’ in connection with the purchase or sale of any securities

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26 See *Tongue v. Sanofi*, 816 F.3d 199 (2d Cir. 2016) (suggesting that the analysis under Omnicare may be more forgiving where plaintiffs are not ‘sophisticated’). See also *Martin v. Quartermain*, 732 F. App’x 37 (2d Cir. 2018). See also *Cavelli v. Ocwen Financial Corp.*, 934 F.3d 1307, 1323 (11th Cir. 2019) (dismissing complaint under Omnicare standard where plaintiff failed to plead that defendants’ statements of opinion [were] mutually exclusive of – or even inconsistent with [defendant company’s] alleged knowledge).

27 See, for example, *Tongue, 815 F.3d at 209-10; City of Dearborn Heights Act 345 Police & Fire Ret Sys v. Align Tech, Inc, 856 F.3d 605, 610 (9th Cir. 2017); In re Sinclair Broad. Grp., Inc. Sec. Litig., 2020 WL 571724, at *8 (D. Md. Feb. 4, 2020).*


29 15 U.S.C. Section 77l(b).
or in connection with security-based swap agreements. While there are currently 11 SEC-promulgated rules in force under Section 10(b), the most important by far is the general anti-fraud rule, Rule 10b-5. Rule 10b-5 prohibits use of any means of interstate commerce to (a) employ any device, scheme or artifice to defraud; (b) make material misstatements or omissions; or (c) engage in any course of business that operates as a fraud against any person, in connection with the purchase or sale of any security or securities-based swap agreement. This rule is the great engine of private securities enforcement in the United States.

In general, to prevail on a Rule 10b-5 claim, a plaintiff must prove that the defendant: (1) made a false statement or an omission of material fact\(^{30}\) (2) with scienter (3) in connection with the purchase or sale of a security (4) upon which the plaintiff justifiably relied\(^{31}\) and (5) that proximately caused (6) the plaintiff's economic loss.\(^{32}\) The most important violations of Rule 10b-5 fall into three categories:

- \(a\) common fraud in transactions by sellers, purchasers, brokers and others;
- \(b\) false or misleading statements of material fact by corporate insiders or others that affect the prices in which securities trade; and
- \(c\) trading on material non-public information by corporate insiders and their tippees (insider trading).

There has been substantial debate and disagreement in the courts over how to construe the reliance element of Rule 10b-5 in the context of class actions. The difficulty is that to proceed as a class under the Federal Rules of Civil Procedure, plaintiffs must show that common questions of law or fact 'predominate over any questions affecting only individual members'.\(^{33}\) But whether a particular buyer or seller relied on an alleged misstatement is

\(^{30}\) It is blackletter law that an omission may be fraudulent only if the omitted information is necessary to make an affirmative statement not misleading. **Basic Inc v. Levinson**, 485 U.S. 224 (1988) (‘silence, absent a duty to disclose, is not misleading under Rule 10b-5’). However, there is presently a division of authority over an issue that potentially conflicts with this landmark feature of the securities law. Specifically, the Second Circuit is at odds with several others over whether a company can face liability under Section 10(b) for failure to disclose ‘known trends and uncertainties’ in compliance with Item 303 of Regulation S-K. Compare **Oran v. Stafford**, 226 F.3d 275, 287 (3d Cir. 2000) (holding that ‘a violation of Item 303 cannot be used to show a violation of Section 10(b) and Rule 10b-5’), **In re Nvidia Corp Sec Litig**, 768 F.3d 1046 (9th Cir. 2014) (same), and **Caravelli v. Ocwen Fin. Corp.**, 934 F.3d 1307, 1331 (11th Cir. 2019) (same, observing that ‘Item 303 imposes a more sweeping disclosure obligation than Rule 10b-5, such that a violation of the former does not ipso facto indicate a violation of the latter’), with **Indiana Public Retirement System v. SAIC, Inc**, 818 F.3d 85 (2d Cir. 2016) (holding that a defendant can be liable under Section 10(b) for failure to make a required Item 303 disclosure, where that omission is material). The Supreme Court granted certiorari to resolve this split in 2017 – but that grant was dismissed after the parties settled.

\(^{31}\) Where a Rule 10b-5 claim is based on omissions, rather than misrepresentations, the Supreme Court has held plaintiffs are entitled to a rebuttable presumption of reliance once the materiality of the omissions is shown. **Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc**, 552 U.S. 148, 159 (2008) (citing **Affiliated Ute Citizens of Utah v. United States**, 406 U.S. 128, 154 (1972)). In addition, there is no requirement that reliance be shown in SEC injunctive or criminal actions under Rule 10b-5. See **SEC v. Morgan Keegan & Co**, 678 F.3d 1233, 1244 (11th Cir. 2012) (reliance is not an element of an SEC enforcement action brought under Rule 10b-5); **United States v. Vilar**, 729 F.3d 62, 88 (2d Cir. 2013) (reliance is not an element in criminal action brought under Rule 10b-5).

\(^{32}\) See, for example, **Dura Pharm Inc v. Broudo**, 544 U.S. 336, 341 (2005).

\(^{33}\) Fed. R. Civ. P. 23(b)(3).
typically an individualised question. Thus, if Rule 10b-5 were interpreted to require proof of individual reliance on defendants’ misstatements, it would be more challenging for plaintiffs’ lawyers to bring claims on a class basis.

The Supreme Court rode to the rescue of plaintiffs in *Basic Inc v. Levinson*,34 endorsing a ‘fraud-on-the-market’ theory under which courts may presume that ‘[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price’.35 This theory obviates the need for proof of individual reliance and facilitates class certification. However, the fraud-on-the-market presumption is only available if a plaintiff can allege and prove that the market was ‘efficient’ — which is to say that market prices were responsive to new, material news. To establish (or refute) the claim of market efficiency, parties present economists armed with event studies analysing how the relevant market reacted to new information.36

More recently, in *Halliburton Co v. Erica P John Fund, Inc*,37 the Supreme Court clarified that Rule 10b-5 defendants can defeat class certification by demonstrating that alleged misstatements had no effect on price. Based on this holding, defendants can now rebut the *Basic* presumption by citing news and analyst reports and other public information that shows how the supposedly undisclosed truth was already known to the market. Courts continue to grapple with the application of this standard. The Second and Sixth Circuits have held that defendants must ‘demonstrate a lack of price impact by a preponderance of the evidence’ under *Halliburton*,38 diverging from the Eighth Circuit, which has suggested that defendants can defeat *Basic* by simply ‘com[ing] forward with evidence showing a lack of price impact’.39 And courts across the country have struggled with plaintiffs pursuing a ‘price maintenance’ theory of liability — under which an alleged misstatement’s lack of price impact can be overlooked so long as the misstatement ‘maintained’ an inflated share price by reinforcing or failing to correct a preexisting market misapprehension. That theory has been accepted by a number of circuit courts.40

35 Ibid. at 247.
36 Notably, the Second Circuit has held that a plaintiff seeking class certification need not introduce evidence showing that a company’s stock price moved in response to the release of information, so long as the record reflects some other evidence of market efficiency. *In re Petrobras*, 862 F.3d 250, 277–78 (2d Cir. 2017). In addition, the Second Circuit has held that plaintiffs need not present any direct evidence of price impact under certain circumstances, suggesting that such evidence may be required only where indirect factors such as trading volume and extent of analyst coverage are less persuasive. *Waggoner v. Barclays Plc*, 875 F.3d 79, 101 (2d Cir. 2017).
38 See *Waggoner v. Barclays Plc*, 875 F.3d 79, 101 (2d Cir. 2017); *Arkansas Teachers Ret Sys v. Goldman Sachs Grp, Inc*, 879 F.3d 474, 482–85 (2d Cir. 2018) (emphasising that defendants are not required to provide ‘conclusive evidence’ showing the absence of a link between price impact and misrepresentation, reversing a lower court’s decision to discount an event study showing the absence of any price decline); *In re Quorum Health Corp.*, 2019 WL 3949704, at *2 (6th Cir. July 31, 2019) (agreeing that defendant bore the burden of rebutting the *Basic* presumption by a preponderance of the evidence). See also *Vizirganakis v. Asterna Zentaris, Inc.*, 775 F. App’x 51, 53–54 (3d Cir. 2019) (holding that an expert report showing inconclusive evidence of stock price movement was insufficient to demonstrate a lack of price impact).
39 See *IBEW Local 98 Pension Fund v. Best Buy Co*, 818 F.3d 775, 782 (8th Cir. 2016).
The Supreme Court has also clarified that courts should not presume that a misstatement caused an inflated purchase price in Rule 10b-5 cases. In *Dura Pharm Inc v. Broudo,* the Court unanimously held that ‘an inflated purchase price will not itself constitute or proximately cause the relevant economic loss’. Following *Dura,* plaintiffs in fraud-on-the-market and other Rule 10b-5 cases must prove that their economic losses were actually attributable to a defendant’s misrepresentations.

In addition, the Supreme Court has repeatedly examined the impact that Section 10(b)’s ‘in connection with’ requirement has on plaintiff standing. As noted above, the Court has generally required that a Section 10 plaintiff demonstrate that he or she was misled into purchasing or selling securities. More recently, the Court has clarified this standard, holding in *Wharf (Holdings) Ltd v. United Int’l Holdings, Inc,* that the sale of an option to buy stock while secretly intending never to honour it also falls within the ‘in connection with’ language. The Court again revisited the scope of Section 10(b) in *SEC v. Zandford,* holding that the provision reached a defendant broker who, by selling a client’s securities and transferring the proceeds to his own account, stole money from a discretionary account. Most recently, the Court held that not only is a Section 10 plaintiff not permitted to sue under a theory that false or misleading statements led them not to buy or sell shares, but that such ‘holder’ transactions are nevertheless pre-empted by SLUSA and barred in state court as well.

**Insider trading in violation of Section 10**

Since the decision of the SEC in *Cady, Roberts & Co,* insider trading – trading on material non-public information – by both corporate insiders and their tippees has been viewed by the SEC and the courts as a violation of Rule 10b-5. As such, a range of defendants can be held liable: insiders who trade on insider information; insiders who disclose material non-public information to others who may then trade (tippers); and the third-party traders who are tipped off by insiders (tippees).

This does not mean that corporate insiders have a duty to disclose all material information to the public. Rather, their duty is to disclose or to abstain from trading until

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42 Ibid. at 341.
43 But see *Erica P John Fund, Inc v. Halliburton Co,* 563 U.S. 804 (2011) (holding that plaintiffs need not prove loss causation at the class-certification stage). The courts have been relatively plaintiff-friendly in crafting a loss- causation standard. See, for example, *Financial Guaranty Ins Co v. The Putnam Advisory Co,* 783 F.3d 395 (2d Cir. 2015); *Loreley Fin (Jersey) No 3 Ltd v. Wells Fargo Sec, LLC,* 797 F.3d 160 (2d Cir. 2015) (‘[I]t is sufficient [for purposes of surviving a motion to dismiss] that the allegations themselves give [d]efendants ‘some indication’ of the risk concealed by the misrepresentations that plausibly materialised in [p]laintiffs’ ultimately worthless multimillion-dollar investment’); *Glickenhaus & Co v. Household Int’l, Inc,* 787 F.3d 408 (7th Cir. 2015) (approving of a ‘leakage’ loss- causation analysis that attempted to model the impact of a gradual disclosure); *Nakkhumpun v. Taylor,* 782 F.3d 1142 (10th Cir. 2015).
44 532 U.S. 588 (2001). Since *Zandford,* the federal circuit courts have dealt with many variations on this issue. See, for example, *Lampkin v. UBS Fin. Servs., Inc.***, 925 F.3d 727, 736 (5th Cir.), cert. denied, 140 S. Ct. 389 (2019) (grant of stock options to employees was not a ‘purchase or sale of securities’ for purposes of Section 10(b) claim).
48 *SEC v. Tex Gulf Sulphur Co,* 401 F.2d 833, 848 (2d Cir. 1968), aff’d in part, rev’d in part, 446 F.2d 1301 (2d Cir. 1971).
disclosure takes place. The duty to disclose material non-public information or abstain from trading has been held to apply not only to registered securities, but to unregistered and delisted securities as well. Since this liability is rooted in Rule 10b-5, it is subject to the purchaser–seller standing requirements discussed above.

To succeed on an insider-trading claim under Rule 10b-5, a plaintiff generally must establish five basic elements: (1) the buying or selling of a security or the tipping thereof (2) on the basis of information about the security that is (3) non-public, (4) material and (5) where trading without disclosure constitutes a breach of a fiduciary duty or other relationship of trust and confidence owed to the source of the information.

Other than materiality (discussed under ‘Forms of action’), the most complex of these elements is the last – the rule that insider-trading liability can attach only if the trading constitutes a breach of a duty. This element is generally satisfied under one of two established theories. Under the ‘classical’ theory, a corporate insider or ‘temporary insider’ working for the benefit of a corporation breaches his duty to the corporation and its shareholders by using confidential corporate information to trade in the corporation’s stock for his or her personal benefit.49 Under the ‘misappropriation’ theory, a tipper or trader who has no duty to the issuer or to shareholders may nevertheless be liable where he or she obtains confidential information in breach of a duty owed to the source of the information. The misappropriation theory was approved by the Supreme Court in United States v. O’Hagan,50 where the defendant was a lawyer who traded based on the information that one of his law firm’s clients was planning a tender offer. In Rule 10b5-2, the SEC has enumerated broad categories that give rise to a duty of trust or confidence to a source of information under the misappropriation theory.

Insider-trading tippees can also be sued or prosecuted under Section 10 and Rule 10b-5. Under the standard established by the Supreme Court in Dirks v. SEC,51 a tippee is liable where: (1) an insider receives a ‘direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings’; and (2) the tippee knew or had reason to know of the tipper’s breach of duty to an issuer.52 As the Supreme Court recently reaffirmed in United States v. Salman,53 insider-trading liability extends to circumstances where an insider gifts non-public information to a ‘trading relative or friend’.54

**Rule 14a-9**

Rule 14a-9 prohibits any proxy solicitation made pursuant to Section 14 of the Exchange Act that ‘contain[s] any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or

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52 Ibid. at 663.
53 137 S. Ct. 420 (2016).
54 Ibid. at 427–28. The Second Circuit recently reiterated that insider-trading liability based on the gift of information to a friend requires evidence of ‘a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the latter’. United States v. Martoma, 894 F.3d 64, 77 (2d Cir. 2018) (noting that ‘there are many ways to establish a personal benefit’). See also Gupta v. United States, 913 F.3d 81, 86 (2d Cir. 2019) (‘Where the recipient of the tip is the tipper’s ‘frequent’ ‘business’ partner, the tipper’s anticipation of a quid pro quo is easily inferable’).
misleading or necessary to correct any statement in any earlier communication . . . which has become false or misleading.\textsuperscript{55} To succeed on a Rule 14a-9 claim, a plaintiff must establish that a proxy statement contained a material misrepresentation or omission that caused the plaintiff injury and that the proxy solicitation itself was an essential link in accomplishing the transaction.\textsuperscript{56} In recent years, this provision has increasingly been invoked by plaintiffs seeking to challenge merger disclosures.\textsuperscript{57} In 2018, for example, some 76 per cent of large mergers were challenged in federal court.\textsuperscript{58} The large majority of such lawsuits are mooted through minor updates to merger disclosures, a practice that has been criticised as yielding little value beyond a mootness fee for plaintiffs’ counsel.\textsuperscript{59}

Unlike Section 10(b), Section 14(a) does not require a showing of manipulative or deceptive conduct. As a result, most courts require proof of negligence, not scienter.\textsuperscript{60} However, some courts have adopted a more nuanced approach to the scienter requirement. For example, the Eighth Circuit has held that while proof of negligence suffices for corporate officer defendants, scienter must be shown where the defendant is an accountant or an outside director.\textsuperscript{61}

\textbf{Section 14(e) and Rule 14e-3}

Section 14(e) broadly prohibits the making of untrue statements and the commission of fraudulent acts in connection with tender offers. Unlike Section 14(a), Section 14(e) has been widely understood to require allegations of scienter.\textsuperscript{62} Recently, however, the Ninth Circuit diverged from this position, holding that Section 14(e) only requires proof of negligence.\textsuperscript{63} In late 2018, the Supreme Court granted an appeal of the Ninth Circuit’s decision, to review

\textsuperscript{55} 17 C.F.R. Section 240.14a-9(a).
\textsuperscript{56} To sustain a Rule 14a-9 claim based on a material omission, a plaintiff must also allege either that a statement was rendered false or misleading by the omitted information or that the defendant had an independent duty of disclosure. See, for example, \textit{In re Willis Towers Watson plc Proxy Litig.}, 937 F.3d 297, 304-06 (4th Cir. 2019); \textit{In re Vivendi, SA Sec Litig}, 838 F.3d 223, 239-40 (2d Cir. 2016).
\textsuperscript{57} See, for example, \textit{Campbell v. Transgenomic, Inc}, 916 F.3d 1121, 1124–25 (8th Cir. 2019) (complaint stated a claim under Section 14(a) and Rule 14a-9 based on allegation that merger proxy was materially misleading in its omission of merger target’s projected net income/loss figures, which were alleged to be significantly lower than disclosed gross profit projections).
\textsuperscript{59} Ibid. at 1790. Mootness fees, which typically range from $50,000 to $300,000, ibid. at 1781, are subject to a lower standard of review than class-action settlements. See generally ibid.
\textsuperscript{60} \textit{See Dekalb County Pension Fund v. Transocean Ltd}, 817 F.3d 393, 408 & n. 90 (2d Cir. 2016); \textit{Beck v. Dobrowksi}, 559 F.3d 680, 682 (7th Cir. 2009) (same); \textit{Herskowitz v. Nutri/Sys., Inc.}, 857 F.2d 179, 190 (3d Cir. 1988) (same).
\textsuperscript{61} \textit{SEC v. Das}, 723 F.3d 943, 953–54 (8th Cir. 2013). See also \textit{Ind State Dist Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc}, 719 F.3d 498, 507 n. 3 (6th Cir. 2013) (‘In this Circuit § 14(a) does in fact require proof of scienter to state a claim.’), vacated and remanded on other grounds sub nom. Omnicare, Inc v. Laborers Dist Council Constr Indus Pension Fund, 135 S. Ct. 1318 (2015). See also \textit{In re Willis Towers Watson plc Proxy Litig.}, 937 F.3d 297, 308 (4th Cir. 2019) (recognising the division of authority, but remanding the question to the district court for further consideration).
\textsuperscript{63} \textit{Varjabedian v. Emulex Corp}, 888 F. 3d 399 (9th Cir. 2018).
the necessity of proving fraudulent intent, and also invited a broader examination of whether private litigants have any right at all to sue under Section 14(e). However, after hearing the argument, the Court reversed course and dismissed the appeal without resolving the issues presented. As such, the *Emulex* decision remains good law within the Ninth Circuit, easing the Section 14(e) state-of-mind requirement for cases brought within that jurisdiction. Given the disagreement among the federal circuits and the apparent interest in re-examining the existence of a private right of action, it is likely that the dispute will find itself back before the Supreme Court in the coming years.

The SEC has also issued several regulations under the authority granted by Section 14(e), the most significant being Rule 14e-3(a), which prohibits any person ‘who is in possession of material information relating to such tender offer which information he knows or has reason to know is non-public and which he knows or has reason to know has been acquired directly or indirectly from’ the tender offeror, the issuer or any officer, director, partner, employee or any other person acting on behalf of the offeror to trade in the affected securities unless the information and its source are ‘publicly disclosed’ ‘within a reasonable time’ before the trade.64 Subsection (d) of the rule prohibits tipping in the tender-offer context, barring certain persons from communicating material non-public information relating to the tender offer where it is reasonably foreseeable that such communication is likely to result in a violation of Rule 14e-3. Rule 14e-3 has the effect of broadening the scope of insider-trading liability in the tender-offer context by dispensing with the requirement that a breach of fiduciary duty be shown.

**Exchange Act: Section 16**

Section 16 of the Exchange Act provides another important source of liability for insider trading. Section 16(a) requires certain insiders to report their transactions and positions in their employers' securities. Section 16(c) bars insiders from shorting their employers' equity securities. Section 16(b) permits a corporation (or derivative plaintiff) to recover short-swing profits from insider trades within a six-month period.

By its terms, the liability created under Section 16(b) is sharply circumscribed, affecting only ‘short-swing’ profits enjoyed by a defined class of insiders, a category defined to include beneficial owners or groups of owners holding 10 per cent or more of an issuer’s shares. However, where an insider runs afoul of the provision, he or she must disgorge all profits.

**ii Procedure**

In general, plaintiffs bringing a complaint in federal court must allege facts sufficient to render their claim plausible on its face, but must allege fraud with particularity. The PSLRA codifies a heightened pleading standard imposed for securities fraud claims brought under the Exchange Act. Under the PSLRA, a securities fraud claim must specify each statement alleged to have been misleading, identify the speaker, state when and where the statement was made, plead with particularity the elements of the false representation, plead with particularity what the person making the representation obtained, and explain the reason or reasons why the statement is misleading. In addition, where scienter is an element of the

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64 17 C.F.R. Section 240.14e-3(a).
securities claim, plaintiffs must ‘state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind’.\textsuperscript{65} Often, a defendant will test the adequacy of a private securities complaint by bringing a motion to dismiss soon after filing.

Federal discovery procedures are liberal, coupling broad mandatory disclosures with invasive depositions, subpoenas and interrogatories. Under the PSLRA, however, in any private action brought under the Acts, all discovery is stayed while a motion to dismiss is pending unless the court finds that particularised discovery is necessary to preserve evidence or prevent prejudice. As such, the federal courts often weigh defendants’ motions to dismiss on a thin factual record, drawing solely from the facts alleged in the complaint, documents that the complaint incorporates by reference, and public information that is available for judicial notice. While the courts have typically been permissive in applying incorporation by reference and judicial notice to expand the record on motions to dismiss, a recent Ninth Circuit decision could signal a retrenchment of this approach. The Ninth Circuit emphasised that judicial notice of public documents is only available for facts ‘not subject to reasonable dispute’, and cautioned that a complaint’s ‘mere mention of the existence of a document’ is insufficient to support incorporation by reference.\textsuperscript{66} If that panel’s sceptical approach is adopted more broadly by the Ninth and other federal circuits, it could complicate the efforts of defendants to achieve early dismissal of complaints that rely upon cherry-picked quotations and selective narratives.

iii Settlements

Far more often than not, securities suits that survive a motion to dismiss are settled rather than litigated to trial. Since securities lawsuits are typically brought as class actions, their settlement can bind absent class members and judicial review of such settlements must comply with Federal Rule of Civil Procedure 23 (Rule 23). Rule 23 requires the court to conduct a hearing and to approve a settlement only after a finding that it is ‘fair, reasonable, and adequate’. In applying this standard, the courts look to a range of factors, including:

\begin{itemize}
  \item \textit{a} the complexity, expense and likely duration of the litigation;
  \item \textit{b} the reaction of the class to the settlement;
  \item \textit{c} the stage of the proceedings and the amount of discovery completed;
  \item \textit{d} the risks of establishing liability;
  \item \textit{e} the risks of establishing damages;
  \item \textit{f} the risks of maintaining the class action through trial;
  \item \textit{g} the ability of the defendants to withstand a greater judgment;
  \item \textit{h} the range of reasonableness of the settlement fund in light of the best possible recovery;
  \item \textit{i} the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.\textsuperscript{67}
\end{itemize}

Under Federal Rule of Civil Procedure 23(e)(5), ‘[a]ny class member may object to [a proposed settlement subject to judicial review]’.

\textsuperscript{65} 15 U.S.C. Section 78u-4(b)(2).
\textsuperscript{66} Khoja v. Orexigen Therapeutics, Inc, 899 F.3d 988, 999–1018 (9th Cir. 2018).
\textsuperscript{67} In re Prudential, 148 F.3d 283, 317 (3d Cir. 1998) (reviewing the settlement of claims brought under Sections 10(b) and 20(b) of the Exchange Act).
Attorneys’ fees are also subject to judicial review in the securities class action context. Under the PSLRA, ‘[t]otal attorneys’ fees and expenses awarded by the court to counsel for the plaintiff class’ in an Exchange Act lawsuit cannot ‘exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class’. More generally, Federal Rule of Civil Procedure 23(h) permits a court to award class counsel ‘reasonable attorney’s fees and non-taxable costs that are authorized by law or by the parties’ agreement’. This ‘reasonableness’ determination can be guided by retainer agreements, fee stipulations embodied in settlement agreements and other fee agreements entered into between lead plaintiffs and class counsel.

iv Damages and remedies

Different remedies are available for the common securities claims described above. For claims brought under Section 11 of the Securities Act, the measure of a plaintiff’s damages is the decline in the value of his or her securities, quantified as the difference between purchase price and sale price. For Section 12 of the Securities Act, the remedy is rescission – the plaintiff tenders his or her securities to the defendant and receives his or her purchase price with interest. Where appropriate, a court can also order injunctive relief for a Securities Act plaintiff.

Remedies available under Section 10, Rule 10b-5, Rule 14a-9 and Rule 14e-3 include both injunctive relief and damages. However, the measure of damages in all Exchange Act claims is limited to ‘actual damages’. In the context of a Rule 10b-5 claim, the Supreme Court has held that this imposes an ‘out-of-pocket’ measure, which is the difference between the price paid or received for the security and its true value at the time of purchase. In insider-trading cases brought under Rule 10b-5, a disgorgement remedy is often available, under which defendants are liable for the profits that they and their tippees obtained. Finally, at least where the plaintiff dealt face-to-face with the defendant and the securities purchased or sold have not been re-transferred, the plaintiff may elect to sue for rescission rather than damages. In a Rule 14a-9 claim, courts have allowed both out-of-pocket and disgorgement damages, as well as fashioning damages designed to give the plaintiff the benefit of the bargain they would have received had the misrepresentations been true.

III PUBLIC ENFORCEMENT

i Forms of action and procedure

The agencies charged with enforcing the securities statutes can proceed through a civil proceeding in court, an internal administrative proceeding, or a criminal prosecution. Notably, while the SEC is empowered to civilly prosecute securities law violators under any of the provisions discussed above, it can also call upon a range of other statutory provisions,

including most importantly Section 17 of the Securities Act. Unlike private litigants, government enforcement agencies generally have standing to enforce all aspects of the federal securities laws.

Section 17 contains a range of proscriptions that collectively endow the SEC with substantial authority to punish fraudulent trading in securities. Sections 17(a)(1), (2) and (3), respectively, prohibit the use of any means of interstate commerce: (1) to employ any device, scheme or artifice to defraud; (2) to obtain money or property by means of material misstatements or omissions; or (3) to engage in any course of business that would operate as a fraud upon a purchaser. In keeping with the general scheme of the Securities Act, Section 17 protects only purchasers and operates only against sellers, unlike Section 10(b) of the Exchange Act, which operates against both purchasers and sellers. The Supreme Court has emphasised that each of Sections 17(a)(1), (2) and (3) contains different prohibitions, to be interpreted separately. Most importantly, a defendant’s bad faith need only be shown in a prosecution under Section 17(a)(1), not (2) or (3). Section 17’s other liability provision, 17(b), prohibits publishing any description of any security without disclosing consideration received from any issuer, underwriter or dealer of the security.

Regardless of the statutory provision that the SEC is enforcing, its investigations generally commence with an informal inquiry, requesting that the subject of an investigation voluntarily provide information or documents. The next step is the entry of a formal order of investigation, permitting SEC staff to issue investigative subpoenas. These orders are typically non-public. At the close of such an investigation, the SEC staff will issue a ‘Wells notice’ to the subject of the investigation, informing that person of the SEC’s preliminary determination of whether securities laws were violated. Where the SEC has determined that no enforcement action will be brought, a termination notice can be sent.

If the SEC determines that there has been a violation of the securities laws, it can commence either a civil proceeding before a court or an internal administrative proceeding. In a civil proceeding, the SEC often seeks an injunction barring further violations of the securities laws and remedies to cure past violations. Remedies can include disgorgement of ill-gotten gains or civil monetary penalties. Damages can be placed in a ‘fair fund’ for disbursements to victims of a defendant’s illegal practices. In an administrative proceeding, the SEC pursues an accelerated ‘trial’ before an administrative law judge (ALJ). The remedies available in this tribunal are much the same as in an ordinary court, though in an administrative proceeding the SEC can request a permanent cease-and-desist order rather than an injunction. In addition, the ALJ in an administrative proceeding can order that a defendant be barred from appearing or practising before the SEC, effectively debarring them from employment in the securities industries. The process for the appointment of SEC ALJs has recently been a subject of controversy, with the Supreme Court holding in June 2018 that ALJs are subject to constitutional restrictions on the appointment of federal ‘officers’, in a decision that raises questions over whether ALJs can be shielded from removal absent cause.

Parallel SEC civil and criminal proceedings are not uncommon. Moreover, the SEC and other agencies sometimes refer matters to other agencies for enforcement action. Where the SEC has determined that a violation of securities laws is potentially criminal, it can refer the matter to the Department of Justice for criminal enforcement. In a criminal enforcement, the defendant is entitled to trial before a jury and conviction turns on whether

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the government can prove guilt beyond a reasonable doubt. Referrals can also be made to self-regulatory authorities (such as FINRA), other agencies (such as the Public Company Accounting Oversight Board) or state agencies.

Because the government authorities have the power to conduct extensive investigations before bringing action, they effectively enjoy discovery rights that greatly exceed even the liberal discovery provisions available in private civil litigation. For example, a criminal investigation can draw upon warrants, wiretaps and other investigative tools that are unavailable to both the SEC and private litigants.

ii Settlements

In negotiating settlements to securities claims, the public authorities have a number of tools at their disposal. In criminal investigations of corporate wrongdoers, the Department of Justice will often negotiate a deferred prosecution agreement (DPA) or non-prosecution agreement (NPA). In a DPA, the Department of Justice files a criminal case but defers prosecuting it, subject to the defendant’s agreement to comply with agreed conditions. In an NPA, the government does not file a complaint, but the result is otherwise much the same. Under either agreement, the defendant typically admits to wrongdoing, waives applicable statutes of limitations, agrees to no longer violate the law, agrees to help the government prosecute other securities-law violators and agrees that it will not disclaim the terms of the agreement. To secure such an agreement, the defendant often must also pay a substantial fine. In weighing whether to prosecute a corporation or negotiate a plea agreement, the Department of Justice looks to a range of factors, including: the corporation’s willingness to cooperate; collateral consequences for the corporation’s employees, investors and customers; collateral non-penal sanctions; the pervasiveness of criminal conduct; and the adequacy of the corporation’s compliance programmes.75

Settlements are also a common conclusion for civil and administrative proceedings initiated by the SEC. Such agreements can impose many of the same conditions as DPAs and NPAs, including stipulated facts and assurances of remedial action to improve compliance and prevent future securities violations. SEC settlements have traditionally not required corporate defendants to admit wrongdoing, although the SEC briefly shifted to a more aggressive posture under the Obama administration.76

Both DPAs and SEC settlements must be filed with and approved by a federal judge. Historically, this review has been very lenient, but on occasion judges will scrutinise proposed settlements critically and sometimes reject them outright, though such decisions are controversial.77 Indeed, recent decisions from the DC and Second Circuits have sharply

77 See, for example, SEC v. Citigroup Global Markets, Inc, 827 F. Supp. 2d 328 (S.D.N.Y. 2011), rev’d 752 F.3d 285 (2d Cir. 2014) (rebuking the lower court for failing to accord the SEC the ‘significant deference’ its policy judgments are owed, and holding that ‘[t]he job of determining whether the proposed SEC consent decree best serves the public interest [. . .] rests squarely with the SEC’).
limited the discretion of courts within those Circuits to review and reject DPAs, as well as district judges’ role in monitoring compliance with DPA conditions. NPAs are not filed with the courts, and are thus not subject to judicial review.

iii Sentencing and liability

Criminal convictions under the securities laws can result in both fines and, for individual defendants, imprisonment. The maximum fines and terms of imprisonment are established by statute, with sentencing guidance provided by the US Federal Sentencing Guidelines. Fines for certain security frauds default to the actual loss associated with the fraud, while in other cases penalties are committed more liberally to the discretion of the sentencing authority.

Where the SEC assesses a civil monetary penalty for a corporation’s violations of the securities laws, it principally looks to two considerations: ‘the presence or absence of a direct benefit to the corporation as a result of the violation’ and ‘the degree to which the penalty will recompense or further harm the injured shareholders’. The SEC also considers seven additional factors: (1) ‘the need to deter the particular type of offense’; (2) ‘the extent of the injury to innocent parties’; (3) ‘whether complicity in the violation is widespread throughout the corporation’; (4) ‘the level of intent on the part of the perpetrators’; (5) ‘the degree of difficulty in detecting the particular type of offense’; (6) the ‘presence or lack of remedial steps by the corporation’; and (7) the ‘extent of cooperation with [the] Commission and other law enforcement’.79

In its recent decision in *Kokesh v. SEC*, the Supreme Court held that disgorgement in SEC proceedings is subject to the five-year limitations period applicable to SEC ‘penalties’.80 In addition, the Court suggested in a footnote that the availability of disgorgement as a remedy in SEC proceedings may be subject to challenge.81 While the full impact of this decision is still developing, it has the effect of limiting the remedies available to the SEC against long-running frauds, hampering efforts to claw back a portion of defendants’ gains – particularly in light of the Court’s 2013 decision in *Gabelli v. SEC*, holding that the relevant limitations period commences on the date of alleged wrongdoing, not the date that wrongdoing is discovered.82 Following *Kokesh*, the lower courts have struggled to evaluate whether other SEC sanctions are similarly subject to the ‘penalty’ limitations period.83

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78 *United States v. Fokker Services BV*, 818 F.3d 733 (DC Cir. 2016) (reversing the rejection of a DPA outside the securities context); *United States v. HSBC Bank USA, NA*, 863 F.3d 125, 135–37 (2d Cir. 2017).
81 Ibid. at 1642 n. 3.
83 See, for example, *SEC v. Gentile*, 939 F.3d 549, 561 (3d Cir. 2019), cert. denied 2020 WL 1906575 (U.S. Apr. 20, 2020) (holding that injunctions do not function as penalties, and collecting cases addressing the issue); *SEC v. Callyard*, 861 F.3d 760, 764 (8th Cir. 2017) (holding that an injunction barring an individual from acting as an unregistered broker was not a penalty, since its purpose was protecting the public from future violations, not retrospective punishment); *Saad v. SEC*, 873 F.3d 297 (DC Cir. 2017) (remanding for further consideration of whether a permanent bar on a broker dealer’s registration was remedial or punitive); *SEC v. Cohen*, 332 F. Supp. 3d 575, 595 (E.D.N.Y. 2018) (holding that an SEC injunction is a penalty).
IV CROSS-BORDER ISSUES

For many years, US courts held that securities claims could be pursued against foreign entities where there was sufficient domestic ‘conduct’ or ‘effects’ to warrant extraterritorial application. In its 2010 decision in *Morrison v. National Australia Bank*, the Supreme Court overturned this line of precedent and held that Section 10(b) of the Exchange Act does not apply to securities transactions that take place wholly outside the United States.84 The Court held that Section 10(b) ‘reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States’.85 In reaching this determination, the Court looked to the ‘focus’ of the statute’s text, and concluded that ‘the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases or sales of securities in the United States’.86 Though *Morrison* dealt with civil liability, the Second Circuit has held that *Morrison*’s holding applies equally to criminal prosecutions under Section 10(b) and Rule 10b-5.87 This decision has been interpreted to apply to the Securities Act as well.88

Since *Morrison*, plaintiffs have unsuccessfully advanced two arguments for allowing at least some foreign transaction claims to proceed under Section 10(b). First, some plaintiffs have contended that a security transaction takes place ‘in the United States’ if the purchase or sale order is made from the United States. Courts have not allowed civil actions relating to foreign issuers to proceed on that ground.89 Second, some plaintiffs have argued that if a foreign issuer lists any portion of its securities on an American stock exchange, all foreign transactions in all foreign shares would be fair game. This theory has also been rejected as contrary to *Morrison*.90

While private litigants have thus failed to overcome *Morrison*, the government has recently met with success in arguing that the Dodd-Frank Act allows the SEC and the Department of Justice to bring securities fraud claims against foreign parties in certain circumstances. Recently, the Tenth Circuit endorsed that position, creating the possibility for a significant expansion in the US government’s power to patrol extraterritorial conduct.91

In applying *Morrison*’s transactional analysis, the focus is on where the purchase or sale actually occurs. Transactions on an exchange presumptively take place where the exchange is located, but for other types of securities the answer is less clear. Where a transaction does not occur on a domestic exchange, courts generally look to the location where ‘the parties incur[red] irrevocable liability’ for the transaction or where ‘title pass[ed]’, following the

85 Ibid. at 273.
86 Ibid. at 266.
87 *United States v. Vilar*, 729 F.3d 62, 67, 70 (2d Cir. 2013). See also *In re Petrobras Securities*, 862 F.3d 250, 271–75 (2d Cir. 2017) (explaining that *Morrison* extraterritoriality issues must be addressed at the class-certification stage).
88 Notably, *Morrison*’s restriction has been interpreted not to bar the extraterritorial application of equitable relief provided by Section 21 of the Exchange Act, including by repatriating and freezing offshore assets.
89 See, for example, *Cornwell v. Credit Suisse Grp*, 729 F. Supp. 2d 620, 624 (S.D.N.Y. 2010).
90 See, for example, *City of Pontiac Policemen’s & Firemen’s Ret Sys v. UBS AG*, 752 F.3d 173, 176 (2d Cir. 2014).
91 See *SEC v. Scoville*, 913 F.3d 1204 (10th Cir. 2019).
Second Circuit’s decision in *Absolute Activist Value Master Fund Ltd v. Ficeto*. Notably, there is an ongoing debate among the federal circuits concerning the application of *Morrison* to unsponsored American depository receipts (ADRs), which facilitate domestic transactions in the shares of foreign issuers. The Second Circuit has held that a domestic transaction in securities similar to ADRs could not defeat *Morrison*’s presumption against extraterritoriality where the transaction and the allegations of law were ‘predominately foreign’. The Ninth Circuit subsequently adopted a less stringent interpretation of *Morrison*, holding that the foreign nature of the underlying fraud is irrelevant so long as it occurred ‘in connection with’ a domestic ADR transaction.

V YEAR IN REVIEW

i Public and private enforcement

According to statistics compiled by NERA Economic Consulting, private plaintiffs filed 433 new federal class-action securities cases in 2019, matching the 2018 total, which marked a nearly two-decade high. This number was driven by a dramatic increase in merger-related lawsuits over the past several years, most likely borne of developments in state law that have rendered the federal forum more attractive. In 2018, the number of these merger-related class actions dipped to 170 (compared with 200 in 2018), while traditional securities class actions rose to 204 (compared with 191 in 2018). The average settlement in 2019 fell to US$30 million from US$69 million the previous year, with median settlement amounts of US$12.8 million and US$11.3 million, respectively.

In the realm of public enforcement, the SEC charged 30 people in cases involving insider trading in FY 2018. Overall, the SEC filed 862 enforcement actions, and obtained orders totalling US$4.35 billion in disgorgement and penalties. And, of course, the mere fact of an investigation – no matter whether it proves grounded in law or fact – can cause extreme injury to target companies and individuals. Among the notable enforcement actions pursued by the SEC in the past year was a case against a major German car manufacturer and

92 677 F.3d 60, 66 (2d Cir. 2012). See also Choi v. Tower Research Capital LLC, 890 F.3d 60 (2d Cir. 2018) (holding that a defendant incurred irrevocable liability even where a domestic transaction was contingent on the subsequent approval of a foreign exchange).

93 Parkcentral Global Hub Ltd v. Porsche Automobile Holdings, 763 F.3d 198 (2d Cir. 2014) (holding that domestic listing is necessary to state claim under Section 10(b), but not sufficient). The Second Circuit has applied its ‘predominantly foreign’ standard in scrutinising a range of foreign transactions. See, for example, Giunta v. Dingman, 893 F.3d 73 (2d Cir. 2018) (transaction between Bahamian entities was subject to US law where the parties entered the relevant agreement in New York and alleged misrepresentations occurred in New York); Prime Int'l Trading, Ltd. v. BP P.L.C., 937 F.3d 94, 105 (2d Cir. 2019) (futures and derivative contracts pegged to foreign crude oil not subject to Commodity Exchange Act provision against manipulation of commodity prices); see also Biofrontera AG v. Deutsche Balaton AG, 2020 WL 1489788, at *7 (S.D.N.Y. 27 March 2020) (claim stemming from German issuer's tender offer not domestic, even though the issuer had American depository shares trading on a domestic exchange that were convertible to foreign shares).

94 See Stoyas v. Toshiba Corp, 896 F.3d 933 (9th Cir. 2018), cert. denied (No. 18-486).


its former CEO for allegedly defrauding investors by raising funds in the public markets while making deceptive claims about the environmental impact of the manufacturer’s vehicles.\textsuperscript{97} The SEC also pursued several significant cases against public companies and individuals that fell short in their securities disclosures.\textsuperscript{98} And the SEC’s Cyber Unit continued its enforcement initiative targeting the perpetrators of fraudulent ‘initial coin offerings’ and other cryptocurrency fraud.

The SEC reported a steep decline in payments made under its whistle-blower programme in 2019, following outlier growth in 2018. In its report for the fiscal year, the SEC announced that it had issued total awards of US$60 million to 8 whistle-blowers, a significant drop from the US$168 million paid out in the prior year.\textsuperscript{99} The lion’s share of this total came from two large awards totalling US$50 million. The SEC also announced a slight drop in total whistle-blower tips, which fell from 5,282 in 2018 to 5,212 in 2019. Following the rapid expansion of the whistle-blower program over the past several years, in June 2018 the SEC proposed controversial amendments to its regulations that would give it more discretion to reduce awards where penalties exceed US$100 million and narrow the definition of the term ‘whistle-blower’, but compensate for these reductions by expanding the types of actions where awards are available.\textsuperscript{100} Those amendments remain in regulatory limbo, after the last-minute cancellation of the meeting at which the SEC was slated to approve them.\textsuperscript{101}

The past year also saw the continued implementation of several recent developments in the Department of Justice’s approach to prosecuting corporate crime, including securities violations. First, in July 2018, the newly installed leader of the DOJ’s Criminal Division issued a memorandum limiting the government’s recent practice of requiring companies that resolve charges through settlement agreements to hire independent monitors to observe their efforts at remediating compliance failures.\textsuperscript{102} Second, in November 2018, the Department of Justice announced that it was relaxing its stringent requirements for crediting corporate defendants’ cooperation in investigations. Under the policy, corporations are eligible for full cooperation credit so long as they identify individuals who are ‘substantially involved’ in misconduct,\textsuperscript{103} whereas previously full credit was contingent on the identification of ‘all

\begin{footnotesize}
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\item 97 See \textit{SEC v. Volkswagen AG}, Case No. 19-cv-1391 (N.D. Cal. 14 March 2019).
\item 100 See SEC Release No. 34-83557 (18 June 2018).
\end{itemize}
\end{footnotesize}
individuals involved in or responsible for the misconduct at issue. Third, the government announced that it had begun broadly applying a non-binding policy under which it would decline to prosecute companies that promptly self-disclose identified misconduct, cooperate with the government’s investigation, fully and timely remediate and disgorge all ill-gotten gains.

DOJ and federal regulators pursuing securities violations in the federal courts also added several new weapons to their arsenal in 2019. Most significantly, as discussed further below, in December 2019 the government scored an important victory expanding the scope of insider-trading liability. Together with the Commodity Futures Trading Commission (CFTC) and the SEC, prosecutors also continued their campaign against spoofing activity by both domestic and overseas traders. This anti-spoofing initiative included a successful joint investigation of a proprietary trading firm that resulted in a $67.4 million settlement and two individuals pleading guilty to wire fraud, commodities fraud and spoofing. In addition, following several unsuccessful spoofing prosecutions, DOJ adopted the aggressive tactic of indicting four alleged spoofers under the Racketeer Influence and Organization Act, a federal criminal statute originally enacted to target organized criminals. For its part, the SEC brought spoofing charges against 18 China-based traders who allegedly manipulated thousands of thinly traded securities.

ii Significant decisions

United States v. Blazczak

In December 2019, the Second Circuit held that the Dirks and Newman requirement of a personal benefit does not apply to criminal insider-trading prosecutions under the wire fraud statute and 18 U.S.C. § 1348, a securities law provision introduced by the Sarbanes-Oxley Act of 2002. In Blazczak, the jury acquitted the defendants of insider-trading charges under Section 10(b), but convicted on the wire fraud and § 1348 counts. The Second Circuit held that the personal-benefit element is unique to the securities-law context and should not be carried over to the criminal provisions at issue. Separately, the Second Circuit also held that the inside information in that case – which concerned upcoming FDA regulatory rulings – constituted ‘property’ in the hands of the government for purposes of the criminal fraud statutes. The net effect of Blazczak will be to broaden tippee criminal liability to include circumstances where inside information is passed indirectly without any clear personal connection between tipper and tippee.


108 947 F.3d 19 (2d Cir. 2019).
United States

North Sound Capital LLC v. Merck & Co.

In September 2019, the Third Circuit introduced an important new limitation on the scope of SLUSA’s preclusion of state-law securities fraud claims. The North Sound\textsuperscript{109} decision held that SLUSA does not preclude individual 'opt-out' claims under state law after the settlement of an underlying securities class action in federal court. Applying a SLUSA provision that precludes litigation if greater than fifty plaintiffs’ state-law securities fraud actions are ‘joined, consolidated, or otherwise proceed as a single action for any purpose’, the Third Circuit concluded that the challenged state actions were not precluded because they had not been ‘somehow combined, in whole or in part, for case management or for resolution of at least one common issue’.\textsuperscript{110} While this interpretation of SLUSA would still preclude opt-out litigation that is coordinated with parallel securities litigation, it means that – in the Third Circuit, at least – defendants will meet more difficulty in seeking to snuff out post-settlement opt-out litigation.

Salzberg v. Sciabacucchi

In March 2020, the Delaware Supreme Court provided an avenue for companies incorporated in that state to channel securities litigation into the federal courts. In Salzburg,\textsuperscript{111} the court held that Delaware corporations can include forum-selection provisions in their charters and by-laws requiring plaintiffs to file any Securities Act claims against them in federal court. If such provisions are broadly adopted, they could diminish the recent rise in state court securities litigation following the US Supreme Court’s Cyan decision, which recognised that federal and state courts have concurrent jurisdiction over Securities Act claims. The Salzberg decision did not address the validity of corporate by-laws designating a forum for claims arising under the Exchange Act.

VI OUTLOOK AND CONCLUSIONS

With covid-19 sweeping the country and Congress focused on pumping money into the domestic economy, it appears unlikely that 2020 will see any significant federal securities legislation. Among the bills sidelined by the pandemic is an overhaul of insider trading law, which would have eliminated the ‘personal benefit’ requirement and broadened the ability of DOJ and the SEC to prosecute trading on stolen information. Whether such legislation remains viable post-pandemic will likely turn on the outcome of the coming federal elections, which will determine the political (and hence regulatory) valence of both the White House and Capitol Hill.

However, notwithstanding this continued legislative inaction, conservatives in the Senate have continued to make significant headway in appointing judges to the federal courts: in addition to placing two new justices on the nine-member Supreme Court, Republicans in the US Senate have confirmed 51 judges on the powerful federal courts of appeals (out of 179 judgeships) and 140 new federal district court judges (out of 663 judgeships). The lifetime appointments of conservative judges to these positions may limit the expansion of US securities liability in the coming years (and decades).

\textsuperscript{109} 938 F.3d 482, 492 (3d Cir. 2019).
\textsuperscript{110} Ibid. at 492.
\textsuperscript{111} 2020 WL 1280785 (Del. 18 March 2020).
The pandemic is also likely to slow the SEC’s rule-making process, though even before the crisis the agency had advanced nothing of significant relevance to securities litigation. And while the SEC’s Division of Enforcement had re-committed itself to the five ‘core principles’ that it announced in 2018 – protecting retail investors, combating cyber-related threats, focusing on individual culpability, increasing reliance on non-monetary sanctions and shifting away from ‘street-sweeps’ – the national crisis is likely to re-orient the SEC’s focus to covid-19 related securities violations. Indeed, the SEC has already suspended trading in the shares of several companies in response to false statements related to covid-19. The DOJ, meanwhile, has also turned its focus to fraud related to the virus.

However, while the pandemic slows legislative and regulatory progress, it is widely expected to bring a glut of litigation targeting the disclosures of public corporations that have been impacted by covid-19 or that are involved in the economy that has sprung up around fighting its spread. Should this boom produce novel claims, they may provide occasion for the federal courts to explore – or revisit – seldom-examined nuances of the federal securities law.

**Liu v. SEC**

Although the Supreme Court’s docket for the coming term is light on cases relevant to the federal securities laws, the Court has granted review of a significant appeal addressing whether the SEC has authority to seek disgorgement in injunctive actions. In *Liu*, the Court will deal with the continuing fallout from its 2017 *Kokesh* decision, which held that SEC claims for disgorgement are ‘penalties’ that must be sought by the SEC within five years of the defendants’ violation. After *Kokesh* expressly declined to address whether disgorgement can be sought in injunctive actions, the unresolved question has been percolating in the federal district and circuit courts. While a decision barring the disgorgement remedy would eliminate a form of relief commonly sought by the SEC, the SEC would still be able to seek disgorgement in administrative proceedings. As such, the practical impact of an adverse decision from the Supreme Court would be to channel more SEC actions into the administrative forum.

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114 Case No. 18-1501 (argued 3 March 2020).
Appendix 1

ABOUT THE AUTHORS

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David Ackebo’s field of expertise includes international arbitration as well as domestic arbitration and litigation. He has acted as counsel for Swedish and foreign clients in complex arbitrations under various rules, such as ICC, AAA/ICDR, SCC, LCIA and SIAC, as well as in ad hoc administrated arbitrations. David has also advised clients and acted as counsel in several high-value disputes before state courts. David’s broad dispute resolution experience includes, among other things, IT, telecoms, construction, M&A transactions, real estate, insolvency and securities-related disputes. In addition to his arbitration and litigation work, David has been engaged in various compliance and anti-corruption matters, including several high-profile investigations.

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Bianca Berardicurti deals mainly with litigation, arbitration, restructuring and insolvency proceedings. She assists leading Italian and foreign financial institutions, corporations and multinational groups in each aspect of the litigation, including pre-litigation risk assessment, in civil, financial, commercial, banking, insolvency and aviation law. She assists clients both in court and in national and international arbitration.

Bianca has gained significant experience in financial litigation, with particular reference to litigation on derivative transactions with public and private entities, as well as in bankruptcy and insolvency law. She also provides assistance in ordinary, provisional and arbitration proceedings concerning energy and related contracts (EPC and O&M agreements, first demand guarantees, performance bonds, etc.).

Bianca has collaborated with the professorship of civil law at the Università degli studi di Roma Tre since 2009.

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Jason has extensive experience representing investment advisers to private equity funds, real estate funds, credit funds, venture capital funds, hedge funds, separate accounts and commodity pools.
He has assisted numerous leading private equity and real estate firms in registering as investment advisers with the SEC and developing Advisers Act compliance programmes.

Jason has worked with over 90 investment advisers on SEC examinations and regularly advises clients on SEC enforcement actions.

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Eva Carman is the co-head of the Ropes & Gray Securities Enforcement Group and Managing Partner of its New York office. Eva’s litigation and regulatory work has received recognition from Best Lawyers in America, Legal 500, Crains and Chambers & Partners, where clients describe her as ‘extraordinarily knowledgeable’, ‘exceptionally smart’ and ‘superb at what she does’.

Eva has thirty years of experience representing private equity firms, hedge funds, credit funds, mutual funds and broker dealers in addressing their most challenging regulatory and enforcement issues. Firms retain her to lead internal investigations, navigate SEC examinations and defend them in SEC enforcement inquiries. Eva’s experience includes leading numerous internal investigations for both public and private boards, assisting clients with more than 200 SEC examinations, and leading the defence of 10 recent enforcement investigations. This breadth of experience, coupled with her knowledge of the industry, makes her a sought after counsellor for some of the world’s most sophisticated firms.

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Nuno is actively involved in national and international arbitration and litigation related to derivatives and other financial products and has advised leading banks and other financial institutions on some of the largest and most complex cases.

He leads high-profile disputes that are often cross-border, including regulatory investigations and enforcement, class actions and other major reputation-threatening litigation, especially where a global strategy is required to deal with litigation that is simultaneously intertwined with civil, criminal, regulatory and administrative issues.

He also represents clients in insolvency and restructuring proceedings, and has participated in numerous cases involving multiple jurisdictions.

He is a member of the supervisory board of Fórum Penal – Associação de Advogados Penalistas, the Associação Portuguesa de Arbitragem (as well as secretary), the Club Español del Arbitraje and INSOL, and is enrolled in the list of arbitrators of Concórdia – Centro de Conciliação e Mediação de Conflitos. He is the author of several publications on arbitration, financial litigation and insolvency.

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Eunice Chen has been practising law for four years. She has handled litigation in various fields, including employment, insurance, product liability, and securities-related actions.

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Chris practises in commercial and public law litigation and has a particular interest in class actions, complex commercial disputes and securities law. A former New Zealand Rhodes Scholar and appellate judge’s clerk, Chris has appeared as an advocate at every level of the New Zealand court system. Chris recently acted for a multinational client in the successful trial defence of a NZ$200 million securities class action in the New Zealand High Court, the first such proceeding in the New Zealand legal system.
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Dr Tobias de Raet advises lindenpartners’ clients on all aspects of corporate and capital markets law, including litigation matters related thereto. He has wide-ranging experience in advising listed corporations, medium-sized companies and start-ups, as well as investors and management members with a particular focus on D&O liability, post M&A-litigation and cross-border matters.

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Thomas specialises in securities law and capital markets transactions. He advises clients on regulatory matters in relation to the Luxembourg financial services industry, and has broad experience in securitisation transactions and capital markets financing, including debt programs and high-yield bonds.

He also has extensive experience in advising clients on a wide range of domestic and cross-border banking transactions, including syndicated loans, general corporate lending and restructuring, both on the lender side and the sponsor side.

He holds an LLM from the University of Luxembourg and a Master 2 in Banking and Financial Law, obtained at the Université du Luxembourg. He also holds a Master 1 in Droit Européen Général from the Université du Luxembourg.

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Harry specialises in shareholder class actions and other heavyweight banking litigation matters for investment and commercial banks. He has recently acted on two of the biggest financial cases in the English courts: the successful defence of a US$1.2 billion claim brought against Goldman Sachs by the Libyan Investment Authority in relation to nine equity derivative transactions entered into by the LIA in the lead up to the financial crisis, and for Lloyds Banking Group (as well as five of its former directors) in successfully defending a claim brought by around 6,000 shareholders in relation to the acquisition of HBOS at the height of the financial crisis. Harry is also acting in relation to a number of defences to Section 90A claims.

Harry has previously helped UBS in two substantial matters: successfully defending claims brought against it by a start-up hedge fund, Decura, in relation to the termination of a joint venture agreement that the two firms had entered into and in relation to the fallout from the identification of a rogue trader (Kweku Adoboli) incurring losses of US$2.3 billion.

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Matthew regularly represents investment and real estate industries professionals in civil proceedings, and acts as lead counsel for large corporations in front of industry tribunals, including the Law Society of Alberta, the Mutual Fund Dealers Association, Investment Industry Regulatory Organization of Canada (IIROC), the Alberta Securities Commission and the Real Estate Council of Alberta. He has been involved in significant arbitral proceedings, including those in the electricity and real estate development industries, and general corporate and commercial matters including employment issues.

Matthew also represents real estate developers and investment professionals in complex class actions.
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Jon acts for banks and other financial institutions, advising them on high-profile regulatory investigations, enforcement proceedings and litigation. Prior to re-joining HSF as a senior associate, he spent four years as a senior member of an investment bank’s litigation and regulatory investigation department, working closely with all business lines, including FX, capital markets and commodities. Jon has advised clients on some of the most high-profile regulatory investigations, including the cross-border investigation into the FX market, and others conducted by the FCA, SFO, DOJ, SEC and CFTC.

Jon has also advised clients on significant disputes, most recently involving the duties of an arranger bank in a debt capital market transaction.

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As a leading Chambers and Partners lawyer of the Asia-Pacific, Tony also actively participates in professional and academic seminars and is a favoured speaker in his field. He is a visiting professor in various law schools in Seoul, and an active member of the Society of Civil Precedents and the International Association of Defense Counsel. Tony has also authored various theses and articles dealing with topics such as commercial disputes, civil liens, commercial leases, accounting books and records, and divorce.

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Frank is the managing partner at Allen & Overy in Luxembourg and specialises in securities laws and capital markets regulation, including stock exchange listings. Clients include banks as well as corporate, institutional, supranational and sovereign issuers, which he advises on debt and equity transactions and structured finance transactions, including securitisation, structured products, covered bonds, IPOs, placements and buy-backs of securities, exchange offers, listing applications and ongoing obligations deriving from such listings. He has 15 years of experience in these areas.
Frank regularly holds conferences on securitisation and other capital markets topics in Luxembourg and abroad. He is a member of the securitisation working group of the Association of the Luxembourg Fund Industry and the securitisation working group and the financial markets committee of the Luxembourg Bankers’ Association. Frank is also a member of the Islamic Finance working group of Luxembourg for Finance (Luxembourg’s agency for the development of the Luxembourg financial centre) and has recently joined the High Committee of the Financial Centre (a committee set up by the Luxembourg Ministry of Finance aiming to modernise Luxembourg’s financial sector legislation).

He is an active member of our fintech task force, supporting clients from established financial institutions, incumbents and start-ups in developing innovative products.

NICOLAS MENNESSON

_Darrois Villey Maillot Brochier_

Nicolas Mennesson is a partner in the litigation department of Darrois Villey Maillot Brochier. He graduated in philosophy from the École Normale Supérieure in 2001 and in business law from Panthéon-Assas University (Paris II) in 2007, with high honours.

Mr Mennesson’s practice focuses on business litigation. He has particular experience in the area of corporate and securities law, including market abuse, transparency requirements and public takeovers.

JOSEFINE MOVIN ØSTERGAARD

_Bruun & Hjejle_

Josefine Movin Østergaard is a senior associate at the Danish law firm Bruun & Hjejle, where she works with managing partner Karsten Kristoffersen in the firm’s dispute resolution group. She is engaged in proceedings both before the courts and in arbitration cases. Her main practice areas are financial products, securities law and corporate investigations. In 2014–2015, Josefine Movin Østergaard completed an LLM in Litigation and Dispute Resolution at UCL in London.

LAURA PAGLIA

_Borden Ladner Gervais LLP_

Laura Paglia is the regional co-lead of Borden Ladner Gervais’ securities litigation and regulatory group. Laura has practised in securities law and regulatory matters throughout her legal career.

Laura’s practice encompasses the representation of numerous full service and discount investment dealers, mutual fund dealers, futures dealers, investment funds, underwriters, private funds, investment banks, introducing and clearing firms, investment advisers, portfolio managers, compliance professionals, research analysts, directors and officers, industry associations and other market participants.

Laura provides ongoing legal advice on compliance, regulatory and securities industry issues as well as representation in civil proceedings and a variety of regulatory proceedings and investigations conducted by provincial securities commissions, the Investment Industry Regulatory Organization of Canada, the Mutual Fund Dealers Association of Canada and other regulatory bodies, the Crown and federal criminal authorities.
Laura’s practice includes disputes in respect of various alleged securities law breaches, shareholder right litigation, mergers and acquisition and take-over bid litigation, and directors’ and officers’ liability.

Laura provides various in-house training programmes for market participants and is a frequent speaker on and written contributor to topical securities issues.

STEFANO PARLATORE

*Legance – Avvocati Associati*

Stefano Parlatore co-heads the dispute resolution department of Legance. He has almost 30 years’ experience in assisting financial institutions and corporations on complex cross-border corporate financial, commercial and insolvency disputes, arbitrations and arbitrations. Stefano represents and assists clients before ordinary courts, including proceedings relating to interim measures, and before special agencies (Bank of Italy and the Italian Companies and Exchange Commission – CONSOB) and authorities, as well as the specialised branches for intellectual property matters and the Italian Data Protection Authority. He also has extensive experience in the extra-judicial phase, including conciliation procedures. Finally, he has also developed substantial experience in insolvency and restructuring matters by advising several Italian and foreign financial institutions and funds, active in the distressed debt market, default portfolio trading, turnaround transactions, in extraordinary administration and bankruptcy, and in debt restructuring.

DARIA PASTORE

*Legance – Avvocati Associati*

Daria Pastore assists and represents a number of Italian and international companies operating in a variety of industrial and commercial sectors in disputes concerning civil, commercial, banking and finance matters. In particular, she has represented clients in disputes including urgent and interim measure proceedings, concerning agency, distribution, supply and commercial lease agreements, international sale of goods contracts, unfair competition, product liability, trademark and patent infringement. She has also assisted Italian clients in corporate litigation, representing directors and companies.

Daria has also gained significant experience in insolvency law and litigation. She has assisted Italian and international companies, funds and financial institutions on complex issues, including international issues, and in litigation relating to the most important insolvency proceedings in Italy.

PAUL PÉPORTÉ

*Allen & Overy*

Paul specialises in securities law and capital markets regulation. He advises clients on the full spectrum of debt and equity transactions, including securitisation, structured products, covered bonds, IPOs, placements and buy-backs of securities, exchange offers, listing applications and ongoing obligations deriving from such listings. He further covers capital market-related regulatory aspects, such as derivatives regulation. Prior to joining Allen & Overy, Paul worked in the credit and rate markets department at JP Morgan in London.

Paul also advises Luxembourg insurers and intermediaries on insurance regulatory matters.
He regularly holds conferences on various capital market and regulatory topics in Luxembourg and abroad. Paul is a member of the Securities Committee of the Luxembourg Bankers’ Association (ABBL). He is also a member of a number of working groups of the ABBL. Paul is also a member of the group of experts of the association of Luxembourg insurers and reinsurers (the ACA), focusing on the application of EMIR to Luxembourg life insurance companies.

He is also an active member of our fintech task force, supporting clients from established financial institutions, incumbents and start-ups in developing innovative products.

LARS RÖH

*lindenpartners Partnerschaft von Rechtsanwälten mbB*

Dr Lars Röh advises lindenpartners’ clients on capital markets and securities law. In particular, he assists banks, savings banks and initiators of mutual funds with the issuance of bonds, structured and fund products, and securities, portfolio and securities-regulatory questions. This work also extends to matters related to good-conduct and compliance requirements. He represents lindenpartners’ clients’ interests in litigation and before the German Financial Supervisory Authority.

Lars Röh attended the universities of Bonn and Kiel. Before joining lindenpartners, he was the head of the capital markets law department at the German Savings Banks Association. He assumed this position after working as a partner at Haarmann, Hemmelrath & Partner.

WILLIAM SAVITT

*Wachtell, Lipton, Rosen & Katz*

William Savitt is the co-chair of the litigation department of Wachtell, Lipton, Rosen & Katz. His practice focuses on representing corporations and directors in litigation involving mergers and acquisitions, proxy contests, corporate governance disputes, securities class actions and regulatory enforcement actions relating to corporate transactions. Mr Savitt graduated from Brown University and received an MPhil from Columbia University in European legal history. He graduated from Columbia Law School in 1997, where he was editor-in-chief of the *Columbia Law Review*. Upon graduation from law school, Mr Savitt served as a law clerk to the Honorable Pierre N Leval of the US Court of Appeals for the Second Circuit for the 1997 term and to the Honorable Ruth Bader Ginsburg of the Supreme Court of the United States for the October 1998 term.

ROXANA SHARIFI

*CMS von Erlach Poncet Ltd*

Roxana Sharifi is a legal practitioner at CMS von Erlach Poncet Ltd. Her main practice areas are litigation before state courts, arbitration matters and financial services, banking and finance and capital markets. During her legal studies, she worked at the chair of commercial and banking law at the Goethe University in Frankfurt, where she focused on corporate and capital markets law. Roxana joined CMS in 2019. She works in English and in her native German language.
EIDER AVELINO SILVA  
*Pinheiro Neto Advogados*

Eider Avelino Silva holds an LLB in law from the São Paulo Catholic University School of Law (PUC-SP), Brazil, in which he graduated with the highest grade point average of all graduating classes (Faculdade Paulista de Direito award), as well as with the highest grade point average in civil law (Professor Agostinho Neves de Arruda Alvim award) and criminal procedural law (Professor Doutor José Frederico Marques award). He also holds an LLM degree (*stricto sensu*) from the São Paulo Catholic University School of Law (PUC-SP), Brazil. A partner at Pinheiro Neto Advogados within the litigation practice, he focuses his practice in corporate, civil, commercial, insurance and reinsurance litigation, dealing with complex, leading domestic and international cases.

TAN YAN YAN  
*Rahmat Lim & Partners*

Yan Yan is a principal in Rahmat Lim & Partners’ financial services department. She has been involved in corporate finance and capital markets-related work including initial public offerings and equity securities offerings. She has experience in cross-border and domestic transactions, mergers and acquisitions, and has advised on foreign direct investment into Malaysia, joint ventures and shareholder arrangements, various commercial contracts, company and securities laws, fund and collective investment scheme formation, and other general corporate exercises.

Yan Yan was also involved in advising a range of clients, including government investment corporations, foreign asset managers, government linked corporations, private limited companies, financial institutions and institutional investors.

KRISTINA VOJTKO  
*Allen & Overy*

Kristina is a senior associate in our international capital markets and banking team. She focuses on general capital markets matters and has a broad range of capital market experience. Prior to joining Allen & Overy in 2019, she worked for another leading law firm in Luxembourg and as a legal counsel at the European Investment Bank.

Kristina is a member of several working groups of the Luxembourg Capital Markets Association.

NATHANIEL WALKER  
*Russell McVeagh*

Nathaniel’s practice spans all aspects of commercial litigation and dispute resolution, with a particular focus on trusts and equitable claims, financial services regulation and insurance law, and disputes with a cross-border dimension. He has significant experience in regulatory investigations, and also regularly provides compliance, law reform and other pre-litigation advice. Nathaniel rejoined Russell McVeagh in late 2017, having spent more than two years in New York practising at Cravath, Swaine and Moore LLP and completing his LLM at Columbia.
WAN KAI CHEE  
_Rahmat Lim & Partners_

Kai Chee’s areas of practice span capital markets, investment funds, private equity, fintech, and mergers and acquisitions.

Kai Chee is the head of the firm’s financial services department and has been involved in mergers, restructurings, schemes of arrangement and vestings, capital reductions, initial public offerings, takeovers, acquisitions and other corporate exercises.

He has experience in cross-border and domestic transactions, and also advises on foreign direct investment into Malaysia, joint venture/shareholder arrangements, various commercial contracts, company and securities laws, fund and collective investment scheme formation, and Labuan and insurance laws. Listings he has worked on include the establishment of real estate investment trusts (REITs), and listings in Malaysia, Singapore, Hong Kong and London.

Kai Chee is recognised as highly regarded in capital markets by _IFLR1000_.

JODOK WICKI  
_CMS von Erlach Poncet Ltd_

Dr Jodok Wicki is the managing partner at CMS von Erlach Poncet Ltd. He has been practising for more than 20 years and concentrates on the resolution of complex disputes. This includes litigation before state courts, international and national arbitration matters where he acts as counsel and sits as arbitrator, international legal assistance matters and proceedings before administrative authorities. His dispute practice spans contract, corporate, banking and insurance matters, as well as white-collar crime and tort cases. He has in addition in-depth knowledge of the insurance industry and is a specialist Swiss Bar Association attorney for tort and insurance law. He represented a large number of corporations in a variety of complex and often international cases. Jodok works in English, French and Italian, in addition to his native German language.

NOAH B YAVITZ  
_Wachtell, Lipton, Rosen & Katz_

Noah B Yavitz is an associate in the litigation department of Wachtell, Lipton, Rosen & Katz. He received a BA from the University of Chicago in 2008, with general honours and honours in linguistics. He received his JD with high honours from the University of Chicago Law School in 2013, where he was a member of the Order of the Coif, a Kirkland and Ellis Scholar, an Olin Fellow in law and economics and an articles editor at The University of Chicago Law Review. Following law school, Mr Yavitz was a law clerk to the Honorable Frank Easterbrook of the US Court of Appeals for the Seventh Circuit.

ZHOU YUHUA  
_DeHeng Law Offices_

Zhou Yuhua holds a doctor’s degree in international economic law from Wuhan University, a full-time MBA from Imperial College London, and was a visiting scholar at Georgetown University. Zhou qualified as a lawyer in China in 1993. She is now a partner at DeHeng Law.
Offices and has 17 years of legal practice experience. She is the legal adviser for many large financial and insurance institutions, and has rich experience in business dispute resolution, insurance, real estate investment and other fields.

SERGEY YURYEV

CMS Russia

Sergey Yuryev is a partner of CMS and has headed the dispute resolution practice in the Moscow office since 2008. Sergey has worked at CMS since 2000. Before joining CMS, Sergey worked at a major American law firm in Moscow, Baku (Azerbaijan) and Washington, DC.

Sergey has extensive experience in representing Russian and foreign clients in complex disputes before state commercial courts, courts of general jurisdiction and various state authorities in Russia, acting for clients in all categories of disputes. He also has substantial experience in handling international arbitration cases before various arbitration institutes (ICAC, SCC, LCIA). Sergey has significant experience in supporting debt restructuring procedures, insolvency (bankruptcy) proceedings and representation in corporate and shareholder disputes. Sergey leads a team of lawyers that provides a full range of services related to the resolution of any disputes in Russia and those having a Russian element in corporate, commercial, administrative and criminal areas.

Sergey graduated from the Moscow State Institute of International Relations in 1995 and from the Southern Methodist University School of Law in 1997. Sergey qualified to practise in New York (US) in 1998, and was admitted to practise in Russia in 1995.

Sergey speaks English and French.

FERNANDO ZORZO

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Fernando Zorzo holds an LLB in Law from the São Paulo Catholic University School of Law (PUC-SP), Brazil, and an LLM degree from the Northwestern University School of Law, Chicago, US. A partner at Pinheiro Neto Advogados within the corporate and capital markets area, he focuses his practice in public offerings of issuance of securities, including IPOs, tender offers, consulting related to corporate and securities regulation, enforcement procedures before the Brazilian securities commission (CVM), corporate reorganisations and M&A transactions.
Appendix 2

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