THE
SECURITIES
LITIGATION
REVIEW
FIFTH EDITION

Editor
William Savitt
ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

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This fifth 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 like 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 (possible) imminent 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, 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. 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 the 2008 crisis gave rise to a new normal in 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 annually reflect 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 Britain that could herald 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 fifth 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
New York
May 2019
Chapter 1

SEC ENFORCEMENT AGAINST PRIVATE EQUITY: A PRACTICAL GUIDE FOR PRIVATE FUNDS

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 real estate, debt and hedge funds. Although the SEC’s priorities for 2019 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 fees charged to advisory accounts where business models may create an increased risk of inadequately disclosed fees, expenses, or other charges.2 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 PRIVATE EQUITY INDUSTRY

SEC enforcement and examinations in 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 market efficiency, diverse ownership of economic exposure and market access.3 In November

1 Eva Ciko Carman and Jason E Brown are partners and Kirsten Boreen Liedl and Daniel Flaherty are associates at Ropes & Gray.
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. In May 2011, the SEC cited IOSCO’s November 2009 report as a useful public source describing conflicts of interest that private fund advisers may face.

In March 2012, provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) became effective. It 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

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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 certain conflicts of interest, including investment and co-investment allocation. 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

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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. In May 2016, Andrew Ceresney (then director of the Division of Enforcement) categorised the SEC’s continued enforcement efforts in three groups: (1) advisers that receive undisclosed fees and expenses; (2) advisers that impermissibly shift and misallocate expenses; and (3) advisers that fail to adequately disclose conflicts of interest.9

These areas of enforcement are relevant to not only the private equity industry, but also other types of investment advisers, who are evaluating their practices and procedures, including real estate, debt and hedge funds. While conflicts of interest have not been front and centre in hedge fund exams historically, examiners are beginning to ask conflict-focused questions. 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.

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, 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,10 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 recent 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

9 See supra, footnote 6.
10 For example, while no enforcement actions have been brought in the private equity space on stapled secondary transactions and few have involved valuations, these raise potential conflicts on which the SEC has focused during exams.
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 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.

Finally, in a matter currently being litigated in federal court, the SEC charged Westport Capital Markets, LLC and its principal for purchasing securities that generated significant amounts of undisclosed compensation. The SEC alleged that Westport would purchase securities from underwriters at a discount and then resell the same securities to its clients at higher prices without disclosing the markup. The securities at issue were risky and caused substantial losses for clients. Accordingly, in the SEC’s view, Westport did not provide clients with sufficient information regarding the conflict of interest, and the clients were, thus, unable to make an informed decision.

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.

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), 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 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 money penalty to settle this matter.

The SEC also alleged that First Reserve Management misallocated expenses to funds without making appropriate closures or obtaining consent. 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 reimburse the funds and revise its practices and disclosures, and agreed to pay a civil money penalty of US$3.5 million.

Similarly, the SEC alleged that Yucaipa Master Manager, LLC (Yucaipa), 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. 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.

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 permit 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.

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 for misallocating expenses between two portfolio companies. Lincolnshire had merged 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 money penalty of US$450,000, to resolve these allegations.

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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 monetary penalty of US$1.5 million to settle these allegations.

Similarly, Potomac Asset Management Company, Inc. (PAMCO) and its president settled with the SEC allegations that PAMCO 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.16 The funds’ governing documents did not authorise or disclose this practice. To settle these allegations, among others, PAMCO agreed to pay a civil monetary penalty of $300,000.

iii 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.17 In that matter, the SEC alleged that JH Partners and certain of its principals provided a loan to the funds’ portfolio companies, thereby obtaining interests in portfolio companies that were senior to the equity interests held by the funds. JH Partners 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 money 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).18 Devlin allegedly arranged for a Pharos-managed fund to purchase notes from an entity owned by a subsidiary of one of its portfolio companies, and for that subsidiary to use a portion of the proceeds

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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.

iv 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. 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 occupied seats on the service provider’s board of directors, 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 money penalty of US$50,000.

Similarly, in a case previously mentioned, Yucaipa’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. 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 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.

This focus 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

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20 See supra, footnote 14.
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 monetary penalties of US$250,000, US$200,000, and US$200,000, respectively.

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 (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. 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 a 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 examination, First Reserve agreed to pay to the funds its *pro rata* share of the discount First Reserve received from the law firm, and provided investors with information regarding its planned practices 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.

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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.

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 judgement. 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.

iii 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.

iv 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. As Andrew Ceresney explained in his May 2016 speech,23 private equity advisers have always been investment advisers subject to the Advisers Act, and

23 See supra, footnote 6.
were therefore fiduciaries subject to the Advisers Act 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.

v 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.

vi Questionnaires
In light of the importance of fees paid to affiliates, advisers should consider regularly sending questionnaires to their personnel regarding any outside business contacts or interests. Any responses should be checked against the adviser's own relationships, as well as those of service providers, portfolio companies, and entities that have relationships with portfolio companies.

V 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.
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).

1 Luke Hastings and Andrew Eastwood are partners at Herbert Smith Freehills. The authors wish to thank Alison Cranney, Leila Khaze, Mark Khunnithi and Jordan Phoustanis 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.3

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.4

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.5

### iii Common securities claims

#### Insider trading and market manipulation

Insider trading and market manipulation are prohibited under Australian law.6 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.7

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.

#### 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

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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).
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 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.

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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.

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: July to December 2015’ (Report No. 476, March 2016); ‘ASIC enforcement outcomes: July to December 2015’ (Report No. 476, March 2016).
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. Directors and auditors have also had to contribute to compensation for affected investors as a result of class actions or ASIC proceedings.

II PRIVATE ENFORCEMENT

i Forms of action

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

Shareholder class actions

Shareholder class actions can be commenced via the opt-out representative procedure that exists in Australia under Commonwealth legislation and under the almost identical

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).

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).


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

Federal Court of Australia Act 1976 (Cth) Part IVA, which was introduced in 1992.
Victorian,\textsuperscript{19} New South Wales\textsuperscript{20} and Queensland\textsuperscript{21} legislation.\textsuperscript{22} A similar regime has been recommended for introduction in Western Australia by the Law Reform Commission of Western Australia,\textsuperscript{23} but is yet to be introduced.

The most common causes of action relied upon are breach by a company of the continuous disclosure provisions of the Corporations Act\textsuperscript{24} and breach by a company of the misleading or deceptive conduct provisions of the Corporations Act and ASIC Act.\textsuperscript{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).\textsuperscript{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:

\begin{itemize}
  \item[a] the company was aware of material, price-sensitive information that it failed to disclose to the market;
  \item[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
  \item[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.
\end{itemize}

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\textsuperscript{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’).\textsuperscript{28} Where previously the major obstacle for litigation funders was the requirement to enter into separate funding agreements with every claimant, a 2016 decision of the Full Court of the Federal Court confirmed that the Court had the power to make a ‘common fund’ order.\textsuperscript{29} This position was recently confirmed at an appellate level.\textsuperscript{30}

Under a ‘common fund’ order, all claimants in a class action funded by a litigation funder would be obliged to contribute to the ‘common fund’ out of any proceeds

\textsuperscript{19} Supreme Court Act 1986 (Vic) Part 4A, which was introduced in 2000.
\textsuperscript{20} Civil Procedure Act 2005 (NSW) Part 10, which was introduced in 2010.
\textsuperscript{21} Civil Proceedings Act 2011 (QLD) Part 13A, which was introduced in 2016.
\textsuperscript{22} See generally, Grave, Adams and Betts, \textit{Class Actions in Australia} (2nd edn, Thomson Reuters, 2012).
\textsuperscript{24} Corporations Act 2001 (Cth) Section 674(2).
\textsuperscript{25} Corporations Act 2001 (Cth) Section 1041H; Australian Securities and Investments Commission Act (Cth) Section 12DA.
\textsuperscript{26} Corporations Act 2001 (Cth) Sections 1041I and 1317HA.
\textsuperscript{27} \textit{Campbells Cash and Carry Pty Ltd v. Fostif Pty Ltd} (2006) 229 CLR 386.
\textsuperscript{28} \textit{Multiplex Funds Management Ltd v. P Dawson Nominees Pty Ltd} (2007) 164 FCR 275.
\textsuperscript{29} \textit{Money Max Int Pty Ltd (trustee) v. QBE Insurance Group Limited} (2016) 245 FCR 191.
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 is likely to result in an increase in both the frequency and scale of shareholder class action proceedings: common fund orders reduce transaction costs for litigation funders and incentivise litigation funders to bring ‘open’ shareholder class actions.

**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. 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.

**ii Procedure**

**Shareholder class actions**

To commence a class action in the Federal Court, the following threshold criteria must be satisfied:

- seven or more persons must have claims against the same person or persons;
- the claims must be in respect of the same, similar or related circumstances; and
- the claims must give rise to a substantial common issue of law or fact.

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. Further:

- one or more representative parties (known as the applicant) bring the action against a respondent on behalf of the entire group;
- there is no certification requirement;
- 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).

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31 Corporations Act 2001 (Cth) Sections 236 and 237.
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 Supreme Court Act 1986 (Vic) Part 4A, Civil Procedure Act 2005 (NSW) Part 10 and Civil Proceedings Act 2011 (QLD) Part 13A.
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.
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 October 2016, the Federal Court introduced a new 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:

- 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;
- disclosure requirements relating to costs agreements and litigation funding agreements, which regulate disclosures to class members, the Court and other parties; and
- guidance on communication with class members.

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.

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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.
42 To date such applications for discovery have generally been unsuccessful: Pathway Investments Pty Ltd & Anor v. National Australia Bank Limited [2012] VSC 72.
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.43

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.44

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).45 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.46

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

43 Corporations Act 2001 (Cth) Section 237.
44 Federal Court of Australia Act 1976 (Cth) Sections 33V and 33X.
47 Corporations Act 2001 (Cth) Section 240.
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’, or a person must suffer loss ‘by’, 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. 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, and there now seems to be tentative judicial encouragement to its proponents, potentially signalling further cases that rely on an indirect causation argument.

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.

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’.


52 HIH Insurance Limited (in liquidation) & Ors (2016) 335 ALR 320; Caason Investments Pty Ltd v Cao (2015) 236 FCR 322; see also Earglow Pty Ltd v Newcrest Mining Ltd [2016] FCA 1433 and Newstart 123 Pty Ltd v Billabong International Ltd [2016] FCA 1194.

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.54 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.55

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:

a commencing criminal prosecutions or referring matters to the CDPP to commence a criminal prosecution;
b commencing civil proceedings for a pecuniary penalty;
c applying to the court for an extensive range of non-pecuniary remedies, including declarations of contravention, compensation orders and injunctions;
d intervening in other civil proceedings;
e 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
f 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.56

ii Procedure

Civil and criminal proceedings

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.57

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,58 which include the power to:

a issue notices to produce;
b execute search warrants; and

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); Australian Securities and Investments Commission Act 2001 (Cth) Section 18.
57 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.
conduct compelled witness examinations under oath (transcripts of which are admissible in certain civil proceedings). 59

ASIC does not have the power to apply for warrants to intercept phone calls. However, it may 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.

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 inadmissible as evidence in any criminal proceeding or proceeding for the imposition of a penalty against the individual. 60 It should be noted that corporations are not protected by the privilege against self-incrimination. 61

ASIC cannot compel the production of documents protected by legal professional privilege; however, ASIC may seek voluntary disclosure of privileged communications. 62

ASIC has adopted a policy of first considering whether it can prosecute market misconduct such as insider trading and market manipulation criminally, and will only consider civil proceedings if this is unavailable. 63 It is of note that ASIC prosecuted Australia’s first successful criminal conviction relating to breaches of continuous disclosure obligations in 2017. 64

If ASIC considers that it has sufficient evidence of a criminal offence, it will normally refer the matter to the CDPP. ASIC will seek to deal with matters through the criminal process where serious conduct is identified that is dishonest, intentional or reckless and where there is sufficient admissible evidence. The CDPP ultimately determines whether to commence a criminal prosecution. 65

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:

a the case to be made against them;

b information relating to the credibility or reliability of prosecution witnesses; and

c 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. 66

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60 Australian Securities and Investments Commission Act 2001 (Cth) Section 68.

61 Corporations Act 2001 (Cth) Section 1316A.


63 ASIC, ‘ASIC enforcement outcomes: January to June 2017’ (Report No. 536, August 2017), Paragraph 15; ASIC, ‘ASIC enforcement outcomes: July to December 2016’ (Report No. 513, March 2017), Paragraph 16; ASIC, ‘ASIC supervision of markets and participants: July to December 2014’ (Report No. 425, March 2015), Paragraph 96; Tony D’Aloisio, ‘Insider trading and market manipulation’ (speech delivered at the Supreme Court of Victoria Law Conference, Melbourne, 13 August 2010).

64 ASIC, ‘ASIC enforcement outcomes: January to June 2017’ (Report No. 536, August 2017), Paragraphs 40–42.


66 See Commonwealth Director of Public Prosecutions, Statement on disclosure in prosecutions conducted by the Commonwealth (22 March 2017), pp. 3–5.
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’. Following the declaration, ASIC can then pursue a pecuniary penalty order, which may be granted if the contravention:

a. materially prejudices the interest of acquirers or disposers of the relevant security;
b. materially prejudices the issuer of the relevant security or its members; or
c. is serious.

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.

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. 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.

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, 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.

**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. The infringement notice will provide for the payment of a penalty.

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.

In determining whether to issue an infringement notice, ASIC will generally consider the seriousness of the alleged breach and the view of the relevant market operator.

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67 Corporations Act 2001 (Cth) Section 1317G(1A).
68 Ibid.
69 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.
70 Corporations Act 2001 (Cth) Section 1317M.
71 Ibid., Sections 1317P and 1317Q.
73 Australian Securities and Investments Commission Act 2001 (Cth) Section 12GG.
75 ASIC, ‘Regulatory Guide 73: Continuous disclosure obligations: infringement notices’ (October 2017), Paragraph 23(e).
76 The infringement notice regime was expanded by the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 (Cth), which received royal assent on 12 March 2019.
77 Ibid., Paragraph 6.
ASIC will only issue the infringement notice after conducting a private hearing at which the entity may give evidence and make submissions.\(^{78}\)

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),\(^ {79}\) and the entity will not be regarded as having contravened the provision specified in the notice.\(^ {80}\) However, ASIC will publish details of the notice and the entity’s compliance.\(^ {81}\) 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.\(^ {82}\)

### 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.\(^ {83}\) While this practice has attracted judicial criticism,\(^ {84}\) 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.\(^ {85}\) 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’.\(^ {86}\)

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 of Australia’s responsible lending laws. The Court’s key reason for declining to

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\(^{78}\) ibid., table 1 and Paragraphs 13–20.

\(^{79}\) Corporations Act 2001 (Cth) Sections 1317DAF and 1317DAU.

\(^{80}\) ibid., Section 1317DAF(4) and 1317DAU(1)(e).

\(^{81}\) ibid., Section 1317DAJ; ASIC, ‘Regulatory Guide 73: Continuous disclosure obligations: infringement notices’ (October 2017), table 1 and Paragraphs 39–40.

\(^{82}\) ASIC, ‘Regulatory Guide 73: Continuous disclosure obligations: infringement notices’ (October 2017), Paragraph 41.


\(^{85}\) 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.

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.87

In criminal prosecutions, charge negotiation can take place at any stage.88 This may result in the defendant ultimately pleading guilty to fewer or lesser charges.89 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.90

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

a. details of the misconduct;
b. details of how the promisor will address the misconduct, such as through the implementation of monitoring and reporting mechanisms; and
c. details of any agreed compensation to third parties or agreement to perform community services, such as funding an education programme.92

ASIC will require that the terms of the enforceable undertaking are publicised.93 Separately, ASIC has noted that it will generally not accept an undertaking that does not acknowledge that its views in relation to the alleged misconduct are reasonably held nor any undertaking containing clauses denying liability or omitting details of the alleged misconduct.94 As a general rule, ASIC will issue a media release regarding the enforceable undertaking and make it publicly available.95 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).96 ASIC has stated that it will only accept an enforceable undertaking if it considers that it provides a ‘more effective regulatory outcome than non-negotiated, administrative or civil sanctions’.97 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,98 or as an alternative to commencing criminal proceedings.99

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92 ibid., table 4.
93 ibid., Paragraphs 43–44.
95 ibid., Paragraph 42.
96 ibid., Paragraphs 78–85.
97 ibid., Paragraph 18.
98 ibid., Paragraph 17.
99 ibid., Paragraph 21.
iv Sentencing and liability

Criminal proceedings

The criminal penalties for securities laws contraventions imposed by courts are increasingly severe, 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) or (2) three times the total value of the benefits obtained that are reasonably attributable to the commission of the offence; or both imprisonment and a fine. Corporations that commit such offences can be fined the greater of:

- A$9.45 million (45,000 penalty units);
- three times the total value of the benefits obtained that are reasonably attributable to the commission of the offence; or
- if the court cannot determine the total value of the benefits for (b) above, 10 per cent of the corporation’s annual turnover during the year preceding the commission of the offence.

Civil penalty proceedings

In civil penalty cases, for individuals, the court may impose a pecuniary penalty of up to the greater of:

- A$1.05 million; and
- the benefit derived or determinant avoided because of the contravention, multiplied by three.

For corporates, the court may impose a pecuniary penalty of up to the greater of:

- A$10.5 million for a corporation for each breach;
- the benefit derived or determinant avoided because of the contravention, multiplied by three; and
- 10 per cent of the annual turnover of the body corporate, up to a maximum of A$525 million.

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. Following the coming into effect of the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 (Cth) in March 2019, for other provisions to which

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100 See, for example: Xiao v. Regina [2018] NSWCCA 4 (where the Court of Criminal Appeal quashed the sentence imposed by the trial judge in 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); Regina v. Glynatsis (2013) 230 A Crim R 99; The Queen v. Jacobson [2014] VSC 592; Commonwealth Director of Public Prosecutions v. Hill and Kamay [2015] VSC 86.
101 Corporations Act 2001 (Cth) Section 1311B.
102 ibid., Section 1311C.
103 ibid., Section 1317G(3).
104 ibid., Section 1317G(4).
105 ibid., Section 1317DAE.
infringement notices apply, ASIC may impose a maximum penalty of half the maximum penalty that a court could impose multiplied by the number of contraventions. For civil penalty provisions, the maximum penalty payable is 12 penalty units (A$2,520) for an individual and 60 penalty units (A$12,600) for a corporation, multiplied by the number of contraventions.\textsuperscript{106}

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:

\textit{a} the foreign issuer’s legal presence in Australia;

\textit{b} whether the foreign issuer is listed on an Australian exchange and the type of listing it has; and

\textit{c} the nature and location of the foreign issuer’s relevant conduct that may form the basis of potential securities actions.

\textbf{Legal presence in Australia}

One aspect of Australian courts’ jurisdiction is the amenability of a defendant to the court’s writ.\textsuperscript{107} Once a defendant has been legally served, a court has jurisdiction to entertain the action against that defendant.\textsuperscript{108} 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:

\textit{a} a foreign company carrying on business in Australia is required to register with ASIC and appoint a local agent\textsuperscript{109} who, among other things, must accept service on behalf of that foreign company;\textsuperscript{110} or

\textit{b} a foreign entity listed on the ASX, whether as an ASX Listing, an ASX Foreign Exempt Listing or an ASX Debt Listing, must appoint an agent for service of process in Australia.\textsuperscript{111}

\textbf{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.

\textsuperscript{106} ibid., Section 1317DAP.

\textsuperscript{107} Lipohar v. The Queen (1999) 200 CLR 485, 516–517 (per Gaudron, Gummow and Hayne JJ).

\textsuperscript{108} 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{109} Corporations Act 2001 (Cth) Section 601CF.

\textsuperscript{110} ibid., Section 601CX.

\textsuperscript{111} ASX, Listing Rules (19 December 2016), Rule 1.1 conditions 4 and 5(b) (ASX listings), Rule 1.11 conditions 7 and 8(b) (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 2017), p. 23.
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.\(^{112}\)

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.\(^{113}\) The provision of such information will still be subject to statutory prohibitions on engaging in misleading conduct.\(^{114}\)

**Location of relevant conduct**

Another aspect of Australian courts’ jurisdiction relevant to foreign issuers is the power of a court to determine a matter,\(^{115}\) 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.\(^{116}\) 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.\(^{117}\) 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.\(^{118}\)

**ii Insider trading**

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

- 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

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\(^{112}\) ASX, Listing Rules (1 December 2017), Rule 1.10.1; ASX, Listing Rules (14 April 2014), Rules 3.1–3.1B; ASX, ASX Listing Rules Guidance Note 8 – Continuous Disclosure: Listing Rules 3.1–3.1B (19 December 2016).

\(^{113}\) ASX, ASX Listing Rules (1 December 2017), Rules 1.15.2, 1.15.3; ASX, ASX Listing Rules Guidance Note 8 – Continuous Disclosure: Listing Rules 3.1–3.1B (19 December 2016).

\(^{114}\) Such as the Corporations Act 2001 (Cth) Section 1041H and the Australian Securities and Investments Commission Act 2001 (Cth) Section 12DA.

\(^{115}\) Lipohar v. The Queen (1999) 200 CLR 485.

\(^{116}\) Under the Competition and Consumer Act 2010 (Cth) or the Australian Securities and Investments Commission Act 2001 (Cth).


\(^{118}\) Competition and Consumer Act 2010 (Cth) Section 5; Australian Securities and Investments Commission Act 2001 (Cth) Section 12AC.
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.119

### 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:

- 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;
- supporting equivalence assessments with counterpart regulators;
- negotiating and implementing bilateral and multilateral agreements and understandings, including fintech-related agreements; and
- supporting initiatives that help the capabilities of regulators in our region.120

ASIC is also increasingly coordinating with securities regulators in other jurisdictions on cross-border issues.121

### YEAR IN REVIEW

#### Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Commission) was established on 14 December 2017, to conduct a broad ranging inquiry into misconduct and conduct falling below community standards in the Australian financial services industry.

The Commission, led by Commissioner Kenneth Hayne AC QC (a former High Court justice) was conducted over the course of 2018. In its examination of the conduct of retail banks, superannuation fund trustees and administrators, insurance companies and other financial service providers, the Commission employed a range of investigatory powers, including the issue of document production notices, notices requiring the submission of witness statements, and the conduct of public hearings involving the examination of representatives of the relevant financial institutions. Seven rounds of public hearings were conducted across 14 weeks between March and November 2018. The Commission culminated in the publication of an interim report (in September 2018) and a final report (in February 2019) which made 24 referrals for potential criminal prosecution and many findings of admitted or possible misconduct or conduct falling below community expectations.

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119 Corporations Act 2001 (Cth) Section 1042B.
Commissioner Hayne was not only critical of the financial services entities, but the industry regulators ASIC and APRA too. He found that ASIC had too infrequently commenced civil penalty proceedings and had confined its enforcement efforts in relation to criminal contraventions to individuals. In particular, he criticised ASIC for its practice of first resorting to entering into negotiated outcomes with accused parties, resulting in out-of-court settlements involving the payment of pecuniary penalties, carefully curated public announcements and no admission of guilt, rather than commencing court proceedings for higher and more meaningful penalties and public censure.

One of the most significant outcomes of the Royal Commission, and the uncovering of various instances of misconduct during the course of the hearings, has been greater scrutiny over the activities of financial service providers (both general business activities and specific instances of conduct). This has already led, and is expected to continue to lead, to a large volume of civil penalty proceedings and class action litigation being instituted by regulators (primarily ASIC and APRA) and private claimants respectively. The regulators and courts have been provided with an increase in resources to deal with the anticipated volume of further litigation.

The Commission, and its criticism of ASIC and APRA’s reluctance to litigate and substantial reliance on ‘soft enforcement tools’ (such as the issue of infringement notices) has, no doubt, incited a shift in the attitude of the regulators towards enforcement through the commencement of civil penalty or criminal prosecution proceedings. ASIC has announced the adoption of a ‘why not litigate’ regulatory stance. The volume of regulatory proceedings has already increased and this trend is expected to continue for some time. By way of example, in late 2018, following hearings concerning consumer financial advice and superannuation, ASIC commenced civil penalty proceedings against two superannuation trustees in relation to the charging of fees for advisory services that were not provided. There has also been an increased appetite to criminally prosecute corporate offences in the course of 2018, which, no doubt, has been precipitated by the findings of and regulatory climate attributable to the Royal Commission. In tandem, the Australian Parliament introduced, and has now passed, the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 (Cth), an amending statute providing for augmented enforcement powers and more severe criminal and civil penalties for misconduct by financial service providers (see below).

ii Greater court scrutiny over settlements with regulators

The aforementioned decision of the Federal Court not to approve a settlement between ASIC and a bank in relation to contraventions of the National Consumer Credit Protection Act 2009 (Cth)122 may have a profound impact on the course and strategy adopted by defendants in regulatory enforcement litigation, and the prospect of reaching an early settlement with ASIC. The decision sets a precedential expectation that the Court may not support vague settlements that do not precisely identify each instance of the conduct complained about, both because the Court is unable to assess the reasonableness of the settlement and because the settlement will not be clear and unambiguous as to the conduct that it covers. This presents some boundaries to parties seeking to minimise admissions and mitigate reputational damage.

Australia

iii  Increasing civil penalties

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 and 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  a consolidated and more uniform penalties framework in these Acts;

c  an extension of the civil penalty regime to apply 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);

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

e  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 by 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 aforementioned 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.

iv  Market integrity enforcement statistics

During the financial year ending 30 June 2018, market integrity remained at the forefront of ASIC’s enforcement agenda. ASIC has reported the following enforcement outcomes under the umbrella of ‘market integrity’ for the financial year ending 30 June 2018.123

<table>
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<th>Administrative</th>
<th>Enforceable undertaking</th>
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<td>18</td>
<td>5</td>
<td>1</td>
<td>31</td>
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</tbody>
</table>

123  ASIC, ‘ASIC enforcement outcomes: June to December 2017 (Report No. 568, August 2018); ASIC, ‘ASIC enforcement outcomes: January to June 2018’ (Report No. 585, February 2018).
VI OUTLOOK AND CONCLUSIONS

Securities litigation, both public and private, continues to be a significant risk facing both issuers and financial market participants. Key areas to watch in the coming year are discussed below.

i ASIC’s litigate-first enforcement strategy

A clear message from the Financial Services Royal Commission was that ASIC has not been aggressive enough in its approach to enforcement. ASIC was criticised by the Commission for rarely going to court to seek public denunciation of, and punishment for, misconduct. Commissioner Kenneth Hayne observed in his Interim Report issued in September 2018 that if ASIC had a ‘reasonable prospect of proving contravention, the starting point must be that the consequences of contravention should be determined by a court’. 124

In response, ASIC confirmed that it has ‘very clearly heard’ that the community expects it to use court processes as much as possible,125 and formally adopted ‘a why not litigate?’ enforcement approach. 126 Under this approach, if ASIC is satisfied that breaches of the law are more likely than not, and it is evident from the facts of the case that the pursuit of the matter would be in the public interest, ASIC will actively ask itself ‘why not litigate this matter?’127 ASIC’s adoption of this enforcement stance is supported by the expansion of its powers and increased penalties, under the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 (Cth), which came into effect in March 2019. Accordingly, in 2019 and going forward, it is expected that ASIC will pursue more enforcement litigation, make an increased number of referrals to the Director of Public Prosecutions, impose increased penalties and be more reluctant to reach agreed outcomes.

ii Courts’ power to resolve competing class actions

In recent years, as a result of the increased availability of litigation funding and the advent of common fund orders, competing class actions have become more common in Australia. Competing actions occur when more than one class proceeding is commenced against a single defendant based on the same factual circumstances and involving substantially identical allegations. The existence of competing classes undermines a fundamental objective of the class actions regime, which is the efficient resolution of multiple claims. It also burdens defendants with the cost and inefficiency of engaging with multiple sets of plaintiffs and litigation funders.

In November 2018, the Full Federal Court handed down its decision in Perera v. GetSwift Limited [2018] FCA 732, confirming that in circumstances where multiple claims have been filed, the court has power to select one of the class actions as the ‘winner’, and allow only that claim to proceed. This may prove to be a popular solution to the issue of competing class actions in 2019 and going forward, because it has the advantage of limiting the burden

125 Speech by Cathie Armour, ASIC Commissioner, at the Australian Securitisation Conference 2018 (Sydney, Australia) 27 November 2018.
127 Speech by James Shipton, ASIC Chair, Conduct Regulator’s Address, the AFR Banking and Wealth Summit (Sydney, Australia) 27 March 2019.
on the resources of both the court and the defendant while maintaining the claimants’ rights to have their claims heard, albeit in one proceeding with one set of legal advisers. However, while the court has confirmed a willingness to address the problem that competing class actions raises, inevitably the solution in each situation will depend on the individual issues involved. Defendants facing multiple class actions must raise these issues on each occasion and the result is not entirely predictable.

iii Potential reform of class action regime

During 2018, the Australian Law Reform Commission (ALRC) conducted an inquiry into and prepared a report in respect of Australia’s class actions regime (the ALRC Report), which was tabled before Parliament on 24 January 2019. Among other things, the Report recommends that there be greater court oversight over third-party litigation funding, to be examined on a case-by-case basis. ASIC has expressed a consistent view in its proposal in its submission to the ALRC. Whether the ALRC’s recommendation is heeded by the legislature, and whether regulatory oversight or a licensing regime is enacted by the legislature, will have an impact on the volume of shareholder class actions and how well resourced they are going forward.
Chapter 3

BRAZIL

Rodrigo Carneiro, Fernando Zorzo and Eider Avelino Silva

I OVERVIEW

i Sources of law

The basic foundations of the Brazilian securities market are set upon:

a Law No. 6,385/1976, which set up the pillars of the Brazilian securities market and created the Securities Commission (CVM).

b Law No. 6,404/1976, which regulated the joint-stock companies, their management and several types of securities related to capital funding.

c Law No. 4,595/1964, which created the National Monetary Council (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, 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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{7} Such redress may occur on the own 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 \textit{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.\textsuperscript{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&Bovespa Supervisão de Mercados (BSM), founded by B3 with the sole purpose of overseeing activities carried out within its own markets.

\textbf{iii  \quad \textit{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:

\begin{itemize}
  \item \textit{a}  court litigation;
  \item \textit{b}  arbitration;
  \item \textit{c}  conciliation; and
  \item \textit{d}  mediation.
\end{itemize}

\textsuperscript{4} Decree No. 6,382/2008, Section IV of attachment I.
\textsuperscript{5} Decree No. 6,382/2008, Article 8 of attachment I.
\textsuperscript{6} Conselho de Recursos do Sistema Financeiro Nacional.
\textsuperscript{7} Law No. 7,913/1989, Article 1.
\textsuperscript{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:

a corporate governance, conflicts of interest, manager misconduct and shareholders’ rights within listed companies; and

b 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.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 to third parties. This wrongdoing may give rise to the filing of *ut universi* lawsuits, *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 (*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,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 (*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,13 if the controlling shareholder14 is responsible for losses of the controlled company. The standing to file this claim lies with:

a the minority shareholders with at least 5 per cent of corporate capital; or

b any shareholder with less than such an amount (in this case, the shareholder must deposit in court an amount equivalent to legal expenses and attorney fees).

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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.

ii 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:

\[ a \quad \text{the party originally obliged to produce evidence in court cannot do so; or} \]

\[ b \quad \text{one of the parties has more ready access to evidence.} \]

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
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 enure 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.

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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:

a the legal entity being the first to qualify among violators related to the same facts;
b the legal entity ceasing its participation in the relevant offence;
c the CVM lacking sufficient evidence to convict the relevant person or legal entity at the time; and
d 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.

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23 Law No. 6,385/1976, Article 10, Paragraph 5.
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,\textsuperscript{26} plus fines of up to three times the illicit benefit obtained.

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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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 2018 saw an increase of 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 357 at the end of 2018, compared with 290 during 2017 and 281 during 2016. On the other hand, there were fewer investigative proceedings initiated in 2018 compared with 2017 and 2016 – 105, 138 and 113, respectively, where:
\[a\] 87 evolved into accusations;
\[b\] 13 are still under administrative investigation; and
\[c\] five were tried through simplified procedure.

There were also fewer administrative sanctioning proceedings initiated in 2018 compared with 2017 and 2016 – 104, 126 and 114.

In 2018, the CVM ruled on a total of 109 administrative sanctioning proceedings, a historic record when compared with previous years. As a result, the administrative proceedings ruled by the CVM’s board of commissioners resulted in:
\[a\] 249 fines;
\[b\] five suspensions;
\[c\] nine disqualifications;

\textsuperscript{26} Law No. 6,385/1976, Articles 27-C and 27-D.
\textsuperscript{27} Law No. 6,385/1976, Article 9, Paragraph 6.
\textsuperscript{28} Law No. 13,105/2015, Article 21.
\textsuperscript{29} Decree-Law No. 2,848/1940, Articles 5 and 6.
d 13 prohibitions; and
e 140 discharges.

The total amount of fines applied in 2018 was 350.3 million reais (in 2017, the fines had amounted to 166.3 million reais). Moreover, 2018 saw a sizable increase in administrative proceedings approved for execution of settlement agreements. In total, 57 proceedings were settled with 179 different entities, generating around 41.22 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.

Finally, the media has reported that a group of Petrobras’ shareholders filed a collective arbitration request against the oil giant for reimbursement of losses from corruption and fraud. This proceeding would benefit investors who traded Petrobras’ shares between 2010 and 2015, the same period considered by the US class action. Although still controversial, as it is the first of its kind in Brazil, it may represent a precedent for the securities market as a whole. The media has also reported that Petrobras would be prepared to deposit approximately 1.25 billion reais to settle losses suffered by Brazilian investors. The outcome of the litigation involving Petrobras is a leading case and very important to the markets, as investors who acquired shares and other securities issued by other listed companies involved in wrongdoing may also try to follow this same legal strategy to recover their losses.

VI OUTLOOK AND CONCLUSIONS

After almost five years of severe financial crisis, Brazil has shown signs of revival and maintaining economic growth in 2019.31 Interest rates in Brazil have reached an all-time low, which should help to drive investors back to the capital markets. The new government that took office from January 2019 is committed to structural reforms in Brazil, such as social security and taxation reforms, which will be important for economic growth and attracting investment.

The market also awaits new developments in the efforts towards enacting a new Commercial Code32 that could put the 1976 Brazilian Corporation Law on a par with cutting-edge legislation.

31 Brazil had a positive GDP of 1.1 per cent in 2018 and 1 per cent in 2017, compared with 2015 and 2016, both with a GDP of 3.5 per cent.
32 Legislative Bill No. 1,572/2011.
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.
I OVERVIEW

i Sources of law
Securities laws in each of Canada’s 10 provinces and three territories provide the foundation for legal and regulatory requirements related to the capital markets. Multiple sources inform securities laws. ‘Laws’ include and are informed by:

a each provincial Securities Act and any regulations or rules pursuant to those acts;
b blanket rulings, orders and decisions issued by each provincial securities regulator;
c National Instruments agreed to by the Canadian Securities Administrators (CSA);2 and
d decisions of provincial courts.3

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:

a the distribution of securities;
b disclosure obligations;
c securities transactions, such as mergers, acquisitions and takeover bids; and
d registration matters.

Enforcement of securities law is achieved in part by provincial securities commissions that function as specialist administrative tribunals and in part by provincial courts. The provincial

1 Laura Paglia and Matthew J Epp are partners at Borden Ladner Gervais LLP.
2 The Canadian Securities Administrators is 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’Autorite des Marches 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.
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) 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 Canada, except 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, 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 C$350,000 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 AMF, provides a mediation service to all clients of registered dealers and advisers. With the exception of Quebec, registrant, investment fund managers and 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

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4 Autorité des Marches Financiers.

the handling of such complaints. IIROC members must also submit to binding arbitration for any claims of C$500,000 or less at the investor's option, though this option is rarely used as, unlike the OBSI, arbitration costs are incurred.

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. 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.

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:

- 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
- the compromise embodied by the settlement falls within the range of reasonableness in the particular circumstances of the case.

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.

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’s or officer’s
circular and issuer bid circular.\textsuperscript{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.\textsuperscript{13}

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}

**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

\begin{itemize}
\item \textsuperscript{12} Ontario Securities Act, RSO 1990, c. Section 5 (OSA), Sections 130 (1) and 131(1)–(3).
\item \textsuperscript{13} OSA, Section 130(1).
\item \textsuperscript{14} OSA, Sections 130(4), (5), 131(5)(d) and 132.
\item \textsuperscript{15} OSA, Sections 130(6) and 130(9).
\item \textsuperscript{16} OSA, Section 138.3(1).
\item \textsuperscript{17} OSA Section 138(1).
\item \textsuperscript{18} OSA, Section 138.1(2).
\item \textsuperscript{19} OSA, Section 138.1(4).
\item \textsuperscript{20} See for example: OSA, Section 138.5.
\item \textsuperscript{21} OSA Section 138.3(6).
\item \textsuperscript{22} OSA Section 138.4(6)(7), the OSA also distinguishes ‘core documents’ from others in Section 138.4(1)(3).
\item \textsuperscript{23} OSA Section 138.1(1).
\item \textsuperscript{24} OSA Section 138.14.
\end{itemize}
bring a derivative action to pursue a claim on behalf of a corporation.\textsuperscript{25} A derivative action requires leave of the court, which must be satisfied 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 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.

\begin{footnotesize}
\begin{enumerate}
\item Canada Business Corporations Act, RSC 1985, c. C-44 (CBCA), Section 238.
\item CBCA, Section 239.
\item CBCA, Section 241.
\item BCE Inv v. 1976 Debenture holders, 2008 SCC 69 (CanLII).
\item For example, OSA, Section 17.
\item For example, OSA, Section 127.
\end{enumerate}
\end{footnotesize}
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 a 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 the 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.

### 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 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.

Though investor restitution is not directly within the power of these public remedies, it is a common element to 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 C$5 million 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 judgments.

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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 Marches 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 Organisation 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, 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. The appeal was dismissed. Among the Ontario Court of Appeal’s rationale was that the legislature did not intend that ‘Ontario would become the 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.

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.

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.
V YEAR IN REVIEW

Private remedies

Secondary market liability

MDC Partners Inc (MDC) was federally incorporated in Canada. It had a registered office in Toronto and a head office in New York State. In October 2014, the SEC began an investigation into the reimbursement of executive expenses and its accounting practices and summoned documents. MDC formed a special committee of independent directors to investigate issues raised by the SEC. After the market closed on 27 April 2015, MDC released a statement disclosing the SEC summons and the creation of the Special Committee. The next day, its share price dropped 20 per cent on the TSX and NASDAQ.

The plaintiffs sought leave to commence the action for secondary market liability pursuant to Section 138.1(1) of the OSA alleging misrepresentations in public filings including annual and quarterly financial reports. Among the misrepresentations alleged was the failure to disclose the SEC investigation and summons.

Leave was denied. Misrepresentation pursuant to the OSA is ‘an untrue statement of material fact’ or ‘an omission to state a material fact that is required to be stated to make a statement not misleading in light of the circumstances in which it was made’. None of the alleged misrepresentations were found to be material. ‘Materiality’ is fact-specific. Information could be ‘considered material if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether to invest and at what price’. The court agreed with the holding in Re: Lions Gate Entertainment Corp, 2016 US Dist. LEXIS 7721SEC, which held that a regulator’s investigation did not trigger a duty to disclose. In the court’s view, a reasonable investor would ‘expect the company would respond to the subpoena, cooperate with the investigator, and conduct an internal investigation and then determine whether there was a material fact to correct or a material change to report to its investors’.

Hostile takeover

As a result of a joint hearing, the OSC and the Financial and Consumer Affairs Authority of Saskatchewan (FCAAS) cease traded a shareholder rights plan adopted by CanniMed Therapeutics Inc (CanniMed). CanniMed’s plan was in response to an unsolicited takeover bid by Aurora Cannabis Inc (Aurora). CanniMed had proposed an acquisition of Newstrike Resources Inc (Newstrike). Aurora launched a hostile bid which was supported by four CanniMed shareholders holding approximately 38 per cent of CanniMed shares. These shareholders entered into hard lock-up agreements with Aurora that committed them to tender to Aurora’s bid and vote against alternative transactions including Newstrike.

CanniMed’s board of directors adopted a poison pill that restricted Aurora from acquiring CanniMed shares, except those tendered to its bid, and prevented Aurora from entering into any more lock-up agreements.

This is the first ‘poison pill’ decision by Canadian securities regulators under the new takeover bid regime that was adopted across Canada in May 2016. The regime includes a

36 Paniccia v. MDC Partners Inc, 2018 ONSC 3470.
37 Re Aurora Cannabis Inc, 2018 ONSEC 10.
longer 105-day, as opposed to 35-day, period to respond to an unsolicited bid, which may be shortened where the target issues a news release announcing that it intends to effect an ‘alternative transaction’.

Aurora applied for and was denied this exemptive relief. Among their reasons, the Commissions stated that abbreviating the 105-day period was not necessary in the circumstances to facilitate the choice by CanniMed shareholders between the transactions.

The Commissions upheld the lock-up agreements and stated that lock-up agreements are a ‘lawful and established feature’ of the merger and acquisition process and are of increased importance in the new takeover bid regime. They held that the agreements did not automatically result in Aurora and the locked-up shareholders acting jointly or in concert.

The Commissions cease traded the poison pill adopted by CanniMed as they concluded it constrained choice by target shareholders.

ii Public remedies

A national regulator

In *Re Pan-Canadian Securities Regulation*, the Supreme Court of Canada reviewed a cooperative proposal by the federal government for a single regulator and held it was constitutional. Provinces can elect to opt in by passing their own legislation to adopt the national regulations and national regulator proposed.

Insider trading

In Ontario, a person is guilty of insider trading if he or she trades in securities of an issuer with material non-public information while in a ‘special relationship’ with the issuer. The range of a special relationship is broad and includes those who have or are considering a relationship with the issuer, such as employees, directors and consultants. A person in a special relationship with an issuer also may be found liable for tipping (as tipper) if he or she informs another person (as tippee) of the material non-public information outside the ordinary course of business.

In *Finkelstein*, information regarding a takeover bid was obtained by a lawyer working on the bid who then told an investment adviser, who passed it to an accountant, who passed it on to other tippees who traded on the information and informed at least one of their clients of the information. The OSC found that all these individuals, including the successive tippees, were in a special relationship with the issuer. The Divisional Court dismissed appeals of all the respondents to the OSC proceeding except one tippee where it held that the OSC had made a number of errors and overturned that conviction. The OSC and one of the respondents appealed to the Ontario Court of Appeal. The Ontario Court of Appeal confirmed that successive tippees were in a special relationship with the issuer. It set out a series of factors it considered relevant to determining whether the tippee would reasonably assume that the material non-public information passed on to him or her came from a person ‘in a special relationship with the issuer’.

38 2018 SCC 48.
39 Section 76(5)(e) of OSA.
The list of non-exhaustive factors or ‘groups of circumstantial evidence’ includes:

- the relationship between the tipper and tippee;
- whether the tipper and tippee work in a setting where transactions and material non-public information are discussed and they know they cannot take advantage of confidential information;
- the nature and detail of the material non-public information;
- the time between the tippee receiving the material non-public information and trading; and
- whether the tippee took any steps to verify the information, had ever owned the particular stock before and whether it was a large trade for the tippee.

The Ontario Court of Appeal stated that the inference that the tippee ‘ought reasonably to have known’ that the tipper was in a special relationship will be stronger where the tippee is a market registrant.

**Definition of security/imprisonment**

In July 2014, the OSC had issued orders against Daniel Tiffin and his company Tiffin Financial Corporation (TFC) regarding promissory notes they had traded. The sanctions included a five-year prohibition on trading in securities. Afterwards, Tiffin solicited C$700,000 from six investors who were also given promissory notes. Tiffin and TFC were charged with breaches of the OSA including trading:

- in securities without being registered;
- without filing a prospectus; and
- while subject to prohibition.

The Ontario Superior Court of Justice dismissed the charges and held that the promissory notes were private loan agreements and not ‘securities’ as defined by the OSA.\(^{41}\) In reaching this conclusion, the Court applied the family resemblance test of the United States Supreme Court.\(^ {42}\)

The family resemblance test presumes:

- the note is a security unless it resembles instruments that are not considered securities after examining the borrower’s motivation for raising the money;
- whether the borrower’s plan resembles common trading for speculation or investment;
- the expectation of the investing public; and
- whether there is a regulation to protect the investor outside of securities laws.

The OSC appealed.

The appeal was allowed. In the Court’s view, the court at first instance erred in its analysis because a ‘security’ was clearly defined in the OSA and reflects policy differences with the US approach. Six months incarceration was ordered. Part of the reasoning to support a period of incarceration was:

- Tiffin’s defiance of the OSC’s cease trade order;
- Tiffin’s use of the funds for luxury goods;

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\(^{41}\) *Ontario Securities Commission v. Tiffin*, 2016 ONCJ 543.

\(^{42}\) *Reeves v. Ernst & Young*, 494 US 56.
the substantial amounts that remained owing under the promissory notes; and prior OSC penalties.

Support letters from clients were among the mitigating factors. The Ontario Court of Appeal has granted leave to appeal this most recent decision.

VI OUTLOOK AND CONCLUSIONS

The Canada Cannabis Act renders it legal to possess, consume, produce and distribute cannabis across Canada as of 17 October 2018. It is anticipated the resulting emerging industry will include increased litigation and regulatory scrutiny.

The cryptocurrency landscape continues to evolve worldwide. On 11 June 2018, the CSA published Staff Notice 46-308, Securities Law Implications for Offering of Tokens, stating that though most of the offering of tokens it reviewed involved investment contracts, the fact that a token has a utility is not solely conclusive of whether the offering constitutes a distribution of securities. The Provincial Securities Commission may increasingly seek to prosecute cryptocurrency investment products.

\[\text{References:}\]

\[\text{43 Ontario Securities Commission v. Tiffin, 2018 ONSC 3047.}\]

\[\text{44 Ontario Securities Commission v. Tiffin 2018 ONCA 943.}\]

\[\text{45 S.C. 2018 c. 16.}\]
Chapter 5

DENMARK

Karsten Kristoffersen

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, respectively, 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 (DFSA) 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 DFSA exercises unitary supervision of the actors on 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 DFSA assists in drafting financial legislation and issues executive orders about the financial markets.

1 Karsten Kristoffersen is managing partner at Bruun & Hjejle. The author wishes to thank Josefine Movin Østergaard for her assistance in producing this chapter.


3 The Capital Markets Act, Section 211.
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.

As at February 2019, 141 companies were listed on Nasdaq Copenhagen. 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.

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 a district court in the first instance. If a case raises issues of a fundamental nature, it may 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). 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.

iii  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, in particular company announcements, and actions about unjustified delay of disclosure of inside information. Such claims are typically directed at either 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.

5  AJA, Part 36 on appeals.
Within the area of securities law, the DFSA is typically concerned with cases relating to insider trading, market manipulation and violation of disclosure requirements as described further in Section III.i.

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 to be responsible for the prospectus. The crucial question is whether that person has in fact taken part in the offering phase or in the drafting of the prospectus. Thus, it is recognised that the actual participation in the preparation of a prospectus may form the basis of prospectus liability.

As an example, in Hafnia, two investors commenced proceedings against the bankruptcy estate and the company’s auditors as well as against the bank acting as the financial adviser. Interestingly, in the judgment of 2 September 1999 of the Maritime and Commercial High Court, all defendants were held liable for the losses suffered as a result of an inadequate prospectus. However, on appeal, the Supreme Court did not find the prospectus to suffer from material defects, and, therefore, the Supreme Court reversed the judgment. Consequently, based on an assessment of the circumstances in each individual case, the person who takes

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part in the offering phase as an investment bank, auditor, lawyer, adviser, originator business, etc., may incur liability. Naturally, the tasks and roles in the offering phase of the individual persons are likely to differ significantly and may also prove to be different from one case to another.

**Liability for other published information**

The 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 of a precise nature;
- that has not been made public;
- that directly or indirectly concerns the issuer; and
- 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 the MAR, an issuer may, in such cases, instead 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:

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

The DFSA must be informed immediately after the disclosure of inside information when the disclosure has been delayed, and the issuer must give the DFSA a written explanation of how the requirements of delay were met. Therefore, when delaying disclosure of inside information, 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.

**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:

- court fees;
- litigation costs, including witness compensation and expenses for expert opinions and translations; and
- costs for legal counsel.

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. The cases of Hafnia and BankTrelleborg are both relevant examples.

### Settlements

As it is also known in other jurisdictions, parties to Danish court proceedings have a duty to examine the possibilities for a settlement. The parties can choose to settle at any point

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10 AJA, Section 348.
11 https://www.minrettsag.dk/frontpage.
12 AJA, Sections 148a–148b.
13 AJA, Section 353.
14 AJA, Section 358.
15 AJA, Section 298.
16 AJA, Section 254a.
17 AJA, Section 336a.
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:

- a principle of restitution, meaning that the injured party is to be fully compensated for his or her loss;
- the injured party should obtain no enrichment from the damages; and
- the injured party has a duty to mitigate his or her loss.\(^{18}\)

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 DFSA has extensive supervisory powers, which include authorisation, supervision and conducting of on-site inspections of financial companies as well as monitoring of compliance with the capital markets regulation. The DFSA, for instance, monitors whether members of management or of the board of directors fulfil the fit and proper requirements in the Financial Business Act and may order a member of management or of the board of directors to resign from his or her position.\(^{19}\)

Investigation by the DFSA may result in the DFSA issuing an order or reprimand. As a general rule, the DFSA is obligated to publish its decisions.\(^{20}\) Both private and public enforcement of securities claims will often be influenced by any initial inquiries, orders or reprimands of the DFSA. If a violation of securities regulation subject to penalty has taken place, and the violation has been significant, the DFSA will evaluate whether there is a basis for forwarding a police report to the Prosecution Service.

Criminal market misconduct offences include:

- insider trading;\(^{21}\)
- unlawful disclosure of inside information;\(^{22}\)
- market manipulation;\(^{23}\)
- breach of disclosure rules;\(^{24}\)
- violation of prospectus rules.\(^{25}\)

\(^{19}\) The Financial Business Act, Section 351.
\(^{20}\) The Capital Markets Act, Section 234. Subject to limitations in the Capital Markets Act, Sections 237–239.
\(^{21}\) MAR Articles 8 and 14.
\(^{22}\) MAR Articles 10 and 14.
\(^{23}\) MAR Articles 12 and 15.
\(^{24}\) MAR Articles 7 and 17.
\(^{25}\) The Capital Markets Act, Sections 12(1) and 247.
Furthermore, the application of the 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 DFSA also supervises.

The DFSA prepares statistics of market abuse cases. The DFSA statistics below outline, as examples, violation of prospectus regulation and unlawful disclosure of inside information.

### Violation of prospectus regulation

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* Several police reports may be included in one case.

### Unlawful disclosure of inside information

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<td>Reprimands and orders</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>Administrative fines</td>
<td>1</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>1</td>
<td>1</td>
</tr>
</tbody>
</table>

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

### Procedure

When the police have completed an investigation, the Prosecution Service will decide whether 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, as for instance 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.

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26 MAR Article 18.

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 DFSA 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 (breach of 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 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.28 If a main office cannot be located, the home court is the judicial district in which one of the members of the management or 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.29

If the defendant is domiciled in an EU Member State, jurisdiction is determined in accordance with the Brussels I Regulation.30 With few exceptions, for example, consumer contract cases31 and the rules on exclusive jurisdiction,32 the courts of the Member State in which the defendant is domiciled will have jurisdiction according to the main rule in

28 AJA, Section 238.
29 AJA, Section 243.
31 ibid., Articles 17–18.
32 ibid., Article 24.
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 together with the changes described in Section II.i as a result of MAR, which entered into force on 3 July 2016, are yet to be fully tested, and Danish legal practitioners will observe any developments closely.

As also evident from the statistics mentioned in Section III.i, one report on unlawful disclosure of inside information was forwarded to the Danish police in 2018. This was a police report of 25 January 2018 filed by the DFSA against the Danish football club Aalborg Boldspilklub A/S (AAB) listed on Nasdaq Copenhagen. Following a leak of information about negotiations concerning the sale of a player between AAB and a Chinese football club, including information about the sale price, AAB issued a company announcement confirming that negotiations were ongoing. The DFSA found that, due to the precise nature of the leaked information, AAB should also have confirmed the sale price and the expected effect of the sale on the company’s outlook and that failure to do so resulted in a violation of MAR Article 17(7). On 7 August 2018, AAB accepted a fine of 30,000 kroner for this violation and violations of the rules on insider lists in MAR Article 18(1) and (4) also relating to the same incidents.

In 2018, another case within public enforcement attracted considerable attention, namely the criminal proceedings against the founder and former CEO of the Danish lighting company Hesalight A/S, against which bankruptcy proceedings were initiated in November 2016. The founder and former CEO was 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 six institutional investors who placed investments in corporate bonds for approximately 562 million kroner. In its judgment of 24 January 2019, the District Court of Roskilde found the founder and former CEO guilty of all charges and convicted him to a fine and seven years’ imprisonment. The matter was placed under the maximum penalty of eight instead of six years due to the aggravating nature of the crimes committed. The court found evidence of fraud of 351 million kroner. The fact that the investors had not performed their own due diligence before investing in Hesalight did not exclude criminal liability. It has been announced that the judgment will be appealed.

33 Ibid., Article 7(1).
34 Ibid., Article 7(2).
35 Ibid., Article 7(5).
Within the private enforcement area, attention has remained, throughout the last year, 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 are seven pending private enforcement actions relating to OW Bunker, which have been initiated by:

- 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;
- a consortium of Danish private investors (Foreningen OW Bunker-Investor);
- a consortium of primarily foreign institutional investors led by the Deminor Group; and
- the bankruptcy estate itself, which has brought three actions that were made possible by way of a litigation funding agreement between the estate and the hedge fund Lion Point Master Fund.

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 IPO. The plaintiffs mainly argue that the OW Bunker Offering Circular of 18 March 2014 suffered from material defect 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, since November 2017, two of the four investment banks organising the IPO.

More than 15 law firms are involved in the Prospectus Liability case alone. The case exclusively involves Danish law and was brought before the Danish courts. The parties to the case come from, inter alia, Denmark, Luxembourg, Sweden, Guernsey and England.

In the action initiated by the consortium of Danish private investors (Foreningen OW Bunker-Investor), the consortium was, on 30 October 2018, granted free legal aid meaning that the legal proceedings will be financed by the Danish government. The rules on legal aid can be found in AJA, Part 31. According to, for instance, AJA Section 329, the Department of Civil Affairs may grant free legal aid when cases involve principles of a fundamental legal nature, are of general public interest or affect to a considerable extent the applicant’s social or occupational situation.

Owing to their fundamental nature, all of the seven pending OW Bunker cases have been referred from a district court to the Eastern High Court in the first instance. Interestingly, the Eastern High Court has directed (in the most recent decision of 22 November 2018), in accordance with AJA Section 254, that all the seven OW Bunker cases 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.
VI OUTLOOK AND CONCLUSIONS

The outlook as to private securities actions will be influenced by the progress of the OW Bunker cases described in Section V. These cases 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.

At the beginning of 2019, a number of Danish and international investors filed or gave notice of their intention to file 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. Two class actions have been initiated before the Danish courts. On 19 September 2018, Danske Bank published conclusions of external investigations into its Estonian branch, which had been mandated by its board of directors and launched in autumn 2017. Danske Bank has appointed counsel to represent the bank in the class actions but has not yet submitted its statement of defence.

Another point of interest is the further development of guidelines on companies’ disclosure obligations in the context of preparing periodic financial information. On this point, the DFSA issued guidelines on 9 October 2017.36 Most recently in a newsletter of 4 March 2019, the DFSA further set out its views following the UK Financial Conduct Authority’s publication of a revised draft Technical Note for consultation in June 2018. During 2018, Nasdaq Copenhagen referred to the guidelines from the DFSA in two cases about publication of interim reports. One of the cases involved the Danish company Per Aarsleff A/S, which on a financial online media (Ritzau Finans) mistakenly had made available an investor relations presentation containing key figures from a half-year report 20 minutes before the report was published. Nasdaq Copenhagen requested a detailed account of the circumstances resulting in the premature disclosure, including whether the half-year report contained inside information. According to the company, neither the half-year report nor the investor relations presentation contained inside information, as the half-year results were as expected and there were no changes to the company’s outlook with respect to the full-year results. Based on the guidelines issued by the DFSA, Nasdaq Copenhagen concluded that the half-year report did not contain inside information. However, the company was reprimanded by Nasdaq Copenhagen’s disciplinary committee according to Nasdaq Copenhagen’s own rule book for not having ensured that all market participants had had equal access to the information in the half-year report.

Since June 2018, the DFSA has also conducted a theme-based review of insider lists based on 88 insider lists received from 30 issuers on Nasdaq Copenhagen. According to the DFSA’s final report published on 1 April 2019, 79 per cent of permanent insider lists contained one or more errors (that is, 23 permanent insider lists out of 29 received), and,

36 Guidelines No. 9973 of 9 October 2017 by the DFSA.
similarly, 75 per cent of event-driven insider lists contained errors (that is, 44 event-driven insider lists out of 59 received).\textsuperscript{37} In its report, the DFSA listed the following key points for issuers to focus on:

\begin{itemize}
\item[a] an insider list must be drawn up every time insider information is identified (irrespective of whether the information is disclosed or disclosure is delayed);
\item[b] insider lists must be drawn up by filling out the standard template provided by the European Commission (Regulation (EU) No. 347/2016); and
\item[c] insider lists must, as a minimum, include the date and time of the obtainment and cessation of the inside information, a description of the reason for a person being included as an insider, the person’s national identification number and contact information of any external counsel.
\end{itemize}

\textsuperscript{37} The DFSA’s report is available at https://www.finanstilsynet.dk/Nyheder-og-presse/Sektornyt/2019/Tema_insiderlister.
I OVERVIEW

Sources of law

England and Wales follows 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\(^2\) (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.\(^3\)

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 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.\(^4\) 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.\(^5\)

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1. Harry Edwards is a partner and Sarah Thomas is a senior associate at Herbert Smith Freehills LLP.
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.
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
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.6

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:

- untrue or misleading statements in prospectuses or listing particulars and the omission of necessary information from such documents (Section 90 claims); and
- 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).

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.
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 includes 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 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 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.

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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 contrast to Section 90 FSMA, which contemplates the action accruing more broadly to those who have ‘acquired the securities’.
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
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 and Prospectus Regulation 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).

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.

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 defendant 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 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

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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.
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 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 on a Section 90 claim to recover its full loss on the securities in question, 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. Outside of an IPO context, difficult questions 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 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. In the

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15 See, for example, *Meridian Global Funds Management Asia Ltd v. Securities Commission* [1995] 2 AC 500 PC.
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.16

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 that arise as a result of responsibility for the allegedly defective statement having been assumed, 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.

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,17 and the directors of a company issuing a prospectus did not assume responsibility to existing shareholders in relation to governance actions (such as voting in an extraordinary general meeting (EGM)).18 There is a live issue in the Lloyds/ HBOS case as to whether directors assume responsibility to shareholders in relation to such governance actions through market announcements and what they say (or do not say) during investor calls. 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 executed19 (see Section V). Directors are also likely to 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.20

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.21 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.22 The burden is therefore great but, if that intention is established, a presumption is raised that the

16 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.


19 Golden Belt 1 Sukuk Company v. BNP Paribas [2017] 3182 (Comm).

20 Another live issue in the Lloyds/HBOS litigation.


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 actual 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.23 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*,24 the court found that Section 2(1) of the Misrepresentation Act could be relied upon 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 Appeal25 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.26

**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

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23 Misrepresentation Act 1967, Section 2(1).
26 *Kaye v. Croydon Tramways* [1898] 1 Ch. 358 CA (Civ Div); *Tiesien 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).

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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.27

Under Section 138D FSMA, a private person28 will have additional claims available where an authorised person has breached eligible29 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.30 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.31 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.32

27 FSMA, Sections 26, 27 and 30.
28 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.
29 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. Hall v. Cable & Wireless Plc [2009] EWHC 1793 (Comm).
30 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.
31 See the Opinion of Advocate General Geelhoed delivered on 13 December 2001 in Case C-254/00 Muñoz v. Frumar 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.
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,33 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 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.34 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.35 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.36 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 (that 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 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, not an opt-out regime, and a sufficient number of claimants will need to be persuaded

33 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.
34 See, e.g., FCA Final Notice of 28 March 2017 in respect of Tesco Plc and Tesco Stores Limited (Tesco).
35 Civil Procedure Rules, Rule 1.1.
36 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.
to bring claims and join the group to make a claim financially viable (or to attract third-party funding). 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 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. A recent increase in the size of court fees for large claims may also help to deter unmeritorious claims.

iii Settlements

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 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.

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. 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).

37 Civil Procedure Rules, Part 36.

38 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).
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 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.

### 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.

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39 Criminal Justice Act 1993, Part V.
40 Financial Services Act 2012, Section 89.
41 Financial Services Act 2012, Section 90.
42 Financial Services Act 2012, Section 91.
43 The FCA and the Crown Office have agreed arrangements for the prosecution of offences in Scotland arising out of FCA investigations.
44 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.
45 Sections 122A–122F in respect of breaches of MAR, and Sections 170–176A FSMA generally.
46 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.\textsuperscript{47}

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.\textsuperscript{48}

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 have occurred and the proposed penalty. It has the power to publish that notice.\textsuperscript{49} 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.\textsuperscript{50} 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,\textsuperscript{51} or seeking judicial review by the courts of some flawed aspect of the FCA’s process on narrow, public law grounds.\textsuperscript{52}

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.\textsuperscript{53} 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

\textsuperscript{47} Section 122D (for market abuse) and Section 176 FSMA.
\textsuperscript{48} Section 174 FSMA.
\textsuperscript{49} Section 67(1)–(3) FSMA.
\textsuperscript{50} Section 67(4)–(6) FSMA.
\textsuperscript{51} Section 67(7) FSMA.
\textsuperscript{52} But see the Court of Appeal decision in \textit{R (Wilford) v. Financial Services Authority} [2013] EWCA Civ 677.
\textsuperscript{53} 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’. 54

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. 55 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. 56

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:

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

The FCA has articulated a five-step penalty setting process. 57 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. 58

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. 59

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

54 See, for example, R v. Innospec Ltd [2010] EW Misc 7 (EWCC) (18 March 2010).
55 Crime and Courts Act 2013, Section 45 and Schedule 17. Although other prosecutors can be designated, this has not as yet occurred.
56 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.
57 DEPP 5.6, DEPP 5.6A-C. The FCA is planning to consult on revising its penalty process.
58 DEPP 6.5.
59 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.60 Under the umbrella of the legislative implementation of 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 the Markets in
the Financial Instruments Directive or the Markets in Financial Instruments Regulation.61

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 Brusselss 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 Kolassa62 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

60 Sections 122G and 122F FSMA.
61 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.
62 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*, 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*.

**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:

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

**ii 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, which enable firms regulated in other EU jurisdictions to carry out regulated activities in the UK where they meet certain criteria.

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 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.

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64 Otherwise known as the Treaty on the Functioning of the European Union.
65 Section 169 FSMA.
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:

\(\text{a} \) admitted to trading on a regulated market or for which a request for admission to trading on such a market has been made;

\(\text{b} \) 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;

\(\text{c} \) that are traded on an organised trading facility (OTF); and

\(\text{d} \) 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.\(^{66}\)

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.\(^{67}\)

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\(^{66}\) 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, that 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.

\(^{67}\) 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.

The claim against Lloyds Banking Group and 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 proceeded to trial in late 2017 and early 2018, and judgment is pending at the time of writing. The investors argue that they were misled into approving the acquisition on the basis that certain information relating to the true financial health of the target bank was omitted from the shareholder circular. They also claim that the directors negligently recommended that shareholders vote in favour of the acquisition on the basis that it was in their best interests. The judgment is likely to provide guidance on a range of topics, that will be of interest to securities lawyers generally, including:

a the nature of the duties owed by issuers and their directors in shareholder circulars;
b whether duties are owed to shareholders for the content of market announcements of transactions and investor presentations;
c the standards applicable to issuers and directors in satisfaction of those duties;
d the role of advisers to issuers and the extent to which issuers can rely on advisers’ performance of their own roles in satisfying their duties to shareholders;
e how a court will assess materiality;
f the role of risk factors in shareholder documentation; and
g a number of issues relating to the principles of quantum of loss and methodologies of calculation.

One of the most significant decisions in last year’s review was the decision of the High Court in Golden Belt\textsuperscript{68} in which Males J found that an arranging bank had owed, and breached, a duty of skill and care that it owed to purchasers of notes to ensure that the underlying transaction documentation had been properly executed. The decision was controversial in that it presented a novel extension of the law of negligence in the context of a capital markets transactions given that until now, the risk of an arranging bank being found to have owed a duty of care directly to purchasers of securities has been perceived to be low. While permission to appeal that judgment to the Court of Appeal was granted, that appeal will no longer be heard as the matter settled during this year.

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

In September 2018, the Court of Appeal handed down judgment in Ukraine v. The Law Debenture Trust Corporation Plc\textsuperscript{69} relating to the payment by Ukraine on notes it had issued with a nominal value of US$3 billion. One aspect of the defence to the claim was that the Trust Deed, which contained the notes’ terms and conditions, contained an implied term to the effect that the holder of the notes shall not prevent or hinder Ukraine’s performance of its payment obligations. It was alleged that the noteholder (Russia) had breached such an

\textsuperscript{68} Golden Belt 1 Sukuk Company v. BNP Paribas [2017] EWHC 3182 (Comm).

\textsuperscript{69} [2018] EWCA Civ 2016.
implied term through its foreign policy interventions in the region, in particular its military activities in Crimea. The Court of Appeal considered that the nature of the instruments as tradeable was a significant pointer against the implication of the terms alleged. The terms of the notes needed to be derived from the documentation that would be available to subsequent purchasers of the notes. Had the implied term contended for been necessary or obvious from the Trust Deed itself, that may have been a different matter. However, it was suggested by Ukraine that the terms could be implied from the general circumstances surrounding relations between Russia and Ukraine. Allowing implied terms which would be binding on subsequent purchasers on such a basis would be contrary to principle.

In another Court of Appeal judgment, *Manchester Building Society v. Grant Thornton UK LLP*, the Court gave important guidance on the correct approach to determining whether losses suffered are within the scope of the duty breached. In that case, the auditors had provided what it accepted was negligent advice about the building society’s ability to apply hedge accounting to a portfolio of interest rate swaps. When the error was identified, the building society closed out the swaps, suffering losses given the mark to market of those swaps caused by the prevailing interest rate environment. In determining that the auditor was not responsible for those losses, even though the building society would not have entered into the swaps but for the negligent advice from its auditor, the Court of Appeal emphasised the important distinction between ‘information’ and ‘advice’ cases. In an information case, the auditor is only responsible for the losses if those losses would not have been incurred had the information been correct. By contrast, in ‘advice’ cases, where the adviser is responsible for ‘guiding the whole decision making process’, all of the foreseeable losses from the negligent advice will be recoverable. In *Manchester*, the advice that the swaps were eligible for hedge accounting was for these purposes merely ‘information’ since the auditor did not guide the whole decision making process of entering the swaps (which was primarily a commercial decision). Since the losses would have been suffered even if the swaps had been eligible for hedge accounting, the losses were not recoverable from the auditor. Applying this in a securities litigation context, it will be critical, for loss causation purposes, to identify whether any alleged breach constitutes an information case (such as a misleading or untrue statement or omission from a document) or an advice case (such as a recommendation to securities holders as to a course of action).

Finally, two cases relate to the ability of claimants to obtain certain categories of documents that may prove helpful to the pursuit of their securities claims. In *R (On the Application of KBR Inc) v. The Director of the Serious Fraud Office*, the court held that the SFO was able to compel a foreign company to produce documents outside the jurisdiction, pursuant to Section 2 of the Criminal Justice Action 1987 (the CJA). This decision potentially increases the scope of documents that, because they will be held by the SFO, could be obtained by claimants in securities litigation. In February 2019, this was followed by a decision to the High Court, *Omers Administration Corporation & Ors v. Tesco Plc*, in which the claimants in a Section 90A FSMA claim successfully obtained documents provided to Tesco by the SFO (including witness statements and interview transcripts) for the purpose of negotiating a deferred prosecution agreement.

70 [2019] EWCA Civ 40.
71 [2018] EWCH 2368 (Admin).
72 [2019] EWCH 109 (Ch).
This was so notwithstanding that the SFO had:

a. obtained these documents using its powers to compel the production of information and documents under Section 2 of the CJA; and

b. provided them to Tesco on the basis that the information they contained would remain confidential.

This has obvious implications for issuers who are the subject of parallel criminal proceedings and civil claims by securities holders.

The Tesco case is ongoing with the parties exchanging pleadings on loss, as well as the interim application regarding documents described above. In addition, there are a number of claimant firms who have widely advertised that they are seeking to bring proceedings in relation to Volkswagen, Quindell (Watchstone), BT, Patisserie Valerie and Petrofac for widely reported issues. One can see the influence of third-party litigation funders, such as Innsworth, and the claimant bar working together to seek potential claimants. If any of these do proceed to trial, we will obtain further guidance on many of the issues described in this chapter.

ii Public

The FCA has created a new primary market oversight department, which has taken over responsibility for the former UK Listing Authority functions of the specialist supervision of sponsors and primary information providers, real-time and post-event monitoring of listed issuers and companies traded on MTFs, the short-selling regime and the post-event review of compliance with certain aspects of the UK Listing Regime.

Following the first use of the FCA’s powers under Section 384 FSMA to require a listed company to pay compensation for market abuse in early 2017,73 the FCA has increased its focus on the quality of disclosures of listed issuers across its supervisory, monitoring, investigation and enforcement activities – and has suggested that it would welcome greater engagement with the issuer community on MAR.

The FCA’s 2018–2019 business plan lists market abuse as one of the key drivers of harm to wholesale markets. Mark Steward, Director of Enforcement and Market Oversight, has continued to signal the importance of market abuse enforcement within the division’s wider strategy. In the FCA’s 2017–2018 annual report, it records 132 market abuse cases as being open as at 31 March 2018, slightly fewer than the year before.

On 17 September 2018 the FCA published a Decision Notice concerning Linear Investments Limited. It found that Linear had failed to take reasonable care to organise and control its affairs responsibly and effectively to ensure potential instances of market abuse could be detected and reported. The main findings were that:

a. when Linear’s business model changed and trading volumes increased, its approach of only undertaking manual oversight of trades did not provide adequate monitoring; and

b. Linear did not appreciate the need to undertake its own separate surveillance of trades based on information available to it and instead it had relied on brokers’ post-trade surveillance.

73 See footnote 33.
Indeed, even when Linear became aware of the need to conduct its own surveillance, it took over a year to begin doing so, which the FCA considered too long a delay. Linear agreed the facts set out in the Decision Notice, as well as liability for the breaches identified, but it disputed the penalty imposed of £409,300 and referred the issue of penalty to the Upper Tribunal. This ‘partly contested’ approach of admitting liability but disputing penalty is a relatively new procedure. In April 2019, the Upper Tribunal published its decision that the FCA’s penalty was appropriate. This result may deter other firms and individuals from pursuing this bifurcated approach.

On 4 February 2019, the FCA published its first fine against an individual for poor market conduct, which amounted to anticompetitive behaviour. Paul Stephany, a portfolio fund manager at Newton Investment Management Limited (Newton) was fined £32,200 for attempting to influence other fund managers at competitor firms to cap orders for shares in an IPO and placing at the same price limit as his orders. He was found to have done this to use the collective power of the firms’ orders to undermine the proper price formation process for the benefit of the funds he managed. In doing so, Mr Stephany was found to have breached Statement of Principle 3, the obligation to observe proper standards of market conduct. The FCA also found that Mr Stephany lacked due skill, care and diligence as required by Statement of Principle 2, because he failed to consider and act within his firm’s written policies on anticompetitive behaviour and issue escalation, did not consult his compliance department or line manager, and did not give due consideration to the risks associated with his communications. The case demonstrates the FCA’s ability to take action against individuals for poor market conduct in respect of securities without needing to satisfy the technical provisions in FSMA and MAR relating to market abuse.

On 22 February 2019, the FCA followed this action against Mr Stephany with a decision notice against three asset managers, including his employer Newton, for sharing strategic information during the same IPO and placing. They were found to have accepted and disclosed otherwise confidential bidding intentions. The FCA used its competition powers to pursue the case, and fined two of the asset managers a total of £414,900. The third was given immunity for reporting the matter under the competition leniency programme.

In December 2018, the FCA issued finalised guidance on insider dealing and market manipulation systems and controls. This outlines observations of good and bad market practice on the requirement to detect, report and counter the risk of financial crime as it relates to insider dealing and market manipulation. It also includes guidance for firms on governance, risk assessment, policies and procedures and ongoing monitoring.

The FCA also continues to take criminal proceedings for market abuse. It brought charges against a former bank compliance officer and 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. The individuals pleaded not guilty on 26 July 2017: the trial took place in late 2018, and in early December the jury announced it had failed to reach a verdict. The FCA is pursuing a retrial.

The FCA’s Tribunal proceedings on whether to prohibit Tom Hayes, a former UBS trader convicted of Yen LIBOR manipulation, continue to be held in deferment pending the outcome of the Criminal Cases Review Commission’s (CCRC) review of Mr Hayes’ conviction. At the time of writing the CCRC has not yet made a determination.
The FCA continued to demonstrate its determination to pursue recovery against individuals convicted of criminal insider dealing. On 11 May 2018, it announced confiscation orders in the sum of £1,074,236 and £624,521 against two individuals (Martin Dodgson and Andrew Hind), convicted in 2016, in prosecutions known as Operation Tabernula.

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. In particular, the judgment in the Lloyds/HBOS case, expected to be handed down shortly, will likely provide judicial guidance on a number of issues of wider application. Moreover, whether claimant firms (and the third party funders they are working with) manage to get any of the various long-threatened claims off the ground will be closely watched.

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 stand-alone securities claims in that area.

In terms of public enforcement, the advent of reporting regime changes that commenced on 3 January 2018 when the recast Markets in Financial Instruments Directive (MiFID II) took effect will further increase the data collected by the FCA, that will give it greater intelligence on which potentially to act. The FCA expects the number of transaction reports captured to increase from around 20 million per day to about 30 million to 35 million per day. In addition, the FCA has a new initiative to enhance its capacity to capture and aggregate order book data via a cloud-based platform – initially on a daily basis from all venues in all cash markets – but eventually across other markets in the future. The FCA hopes this initiative should enable it to make assessments virtually in real time, and to give the FCA the tools to detect suspected market manipulation earlier.

The FCA remains committed to strong enforcement action and the pursuit of criminal prosecutions in market abuse cases. 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. 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.

The FCA’s work on market abuse systems and controls has already been referred to: in addition, 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.
On 13 February 2019, Julia Hoggett, the FCA's new director of market oversight, gave a speech on the FCA's priorities with regard to the regulation and detection of market abuse. Of its enforcement approach, she said:

> our decision to investigate using our enforcement powers is triggered by the FCA having reasonable grounds to suspect that serious misconduct has taken place. With regard to market abuse, we will not shy away from investigating activities taking place in the market that meet this test. It is important to recognise that ignorance of the requirements of MAR, or the absence of intent to commit market abuse, are not a defence to breaches of MAR. Abusive conduct committed in ignorance of the rules can be every bit as serious in its consequences as deliberate, dishonest conduct, and we will pursue it accordingly. Market participants should therefore take all necessary steps to understand their obligations under MAR and ensure that they conduct themselves appropriately.

Following that speech, regulated firms should also be thinking more holistically about the interaction between market abuse requirements and systems and controls for financial crime, for example whether both a SAR and a STOR should be submitted, and whether repeated concerns about the trading behaviour of a client should lead firms to refresh their risk-based analysis of that client from a financial crime point of view, consider enhanced monitoring of that client and ultimately, whether to continue to maintain that client relationship.

In July 2018, following a 2017 discussion paper on the extension of the scope of Principle 5 (market conduct) of the FCA's Principles for Businesses to all authorised firms' unregulated activities (beyond activities that are ancillary to regulated activities), and a consultation on proposals for the regulatory recognition of industry codes as a means by which the regulator should communicate its view of what constitutes proper standards of market conduct with regard to unregulated markets or activities, the FCA published its Policy Statement on these matters. It has decided to establish a process through which it can recognise certain voluntary industry codes in priority areas, that it hopes will to encourage their use, but says will not mandate it. It has agreed to publicly consult on any decision to recognise a voluntary code before doing so. This is a topic that firms will wish to monitor and respond to relevant consultations: there is a significant risk that the effect of these proposals could be to foster the proliferation of a multiplicity of codes all seeking regulatory recognition, also potentially creating increased litigation risk for not merely for regulated firms, but also for other market participants. On the proposal to extend the scope of Principle 5, the FCA has taken on board concern that such an extension would bring in regulation ‘by the backdoor’, without the appropriate parliamentary scrutiny of legislative changes. It has therefore decided not to proceed with this change for now, but it may revisit the issue when there is parliamentary time available to consider changing the underlying legislation.

Finally, greater uncertainty regarding all aspects of securities law governed by EU legislation has, of course, been created by the prospect of a UK exit from the EU. While the terms of that exit remain unclear, legislation will be required to recreate a domestic market abuse regime (that MAR replaced), under which the FCA might recover more freedom to provide guidance to market participants. Nonetheless, decisions made in the process of transposing EU law into UK law are likely to have significant and practical impacts on all participants in the financial markets.
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 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.

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.

The EU also adopted a number of other directives that are relevant to securities litigation, notably the Transparency Directive, the Takeover Directive, the Markets in Financial Instruments Directive and Regulation (MiFID II and MiFIR), 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, 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 it upon the issuance of securities or afterwards. In addition to periodic financial disclosure requirements, the issuers have to immediately disclose to the market any inside information (as 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

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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 to enter into force on 21 July 2019.

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.
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 address 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 from 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' 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

19 For instance, the ESMA recently conducted a consultation on the new Prospectus regulation regarding the subject ‘Technical advice on minimum information content for prospectus exemption’ (‘ESMA publishes the response to its consultations on Prospectus’, ESMA press release of 30 October 2018).

20 For instance, the ESMA announced, and has continuously renewed to date, 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 Article 231-4 et seq. of the AMF General Regulation.


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.
initiate both the investigation and prosecution (and may offer a settlement procedure, see Section III.iii) 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).

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.

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.

29 Article 705-1 of the Criminal Procedure Code.
30 In particular ECtHR, 4 March 2014, Grande Stevens and Others v. Italy, 18640/10, 18647/10, 18663/10, 18668/10 and 18698/10.
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.
34 However, as of 2016, the financial penalties imposed by the AMF can be increased by up to 10 per cent to fund the indemnification of victims (Article L621-15 of the Financial and Monetary Code).
35 Article L623-1 et seq. of the Consumer Code.
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)\(^\text{36}\) 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 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). 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.\(^\text{37}\) 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.\(^\text{38}\) 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.\(^\text{39}\)

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);\(^\text{40}\) 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.

\(^{36}\) Criminal Chamber of the Supreme Court, 11 December 2002, 01-85176 and 18 April 2018, 18-80857.

\(^{37}\) Article L621-12-1 of the Financial and Monetary Code.

\(^{38}\) 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).
(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 long-standing lobbying to this effect, including by the AMF itself. Therefore, shareholders have to 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 and solicit additional mandates, unless authorised to do so by a judicial order. 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.

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 has to 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, 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. The proceeding has to 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 to 24 months. An appeal would last approximately the same, with the court of appeal reviewing the whole case, both from a factual and 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 to 24 months.

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.
43 Article L452-2 et seq. of the Financial and Monetary Code.
44 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).
45 Article R225-167 of the Commercial Code.
46 Article 138 et seq. of the Civil Procedure Code.
47 Article 145 of the Civil Procedure Code.
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

Though 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. As a result, the indemnity awarded to the investors will only represent a portion of their damage, interfering with the legal principle 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 or to broad categories of claimants.

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.

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. 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 (ECtHR)

48 Commercial Chamber of the Supreme Court, 9 March 2010, 08-21547 and 6 May 2014, 13-17632.
49 Paris Court of Appeal, 17 October 2008, 06/09036.
50 Paris Court of Appeal, 17 February 2015, 10/04697.
52 Article L621-14 of the Financial and Monetary Code.
of 10 February 2009 and 4 March 2014, the French Constitutional Court ruled on 18 March 2015 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. Since then, the AMF has been entitled to pursue a market abuse case only if the Public Prosecutor for Financial Matters does not, and vice versa. 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 a clear improvement, the mechanism raises some questions regarding its application. The law sets no criteria as to which cases should be attributed to 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.

The choice between administrative enforcement and criminal prosecution can have significant consequences for the defendant, who faces up to five years’ 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 ECtHR states that when the criteria are not objective and defined there is an infringement of these principles.

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, 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. By the end of their 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 Board also transfers the file

53 ECtHR, 10 February 2009, Zolotoukhine v. Russia, 14939/03, and ECtHR, 4 March 2017, Grande Stevens and Others v. Italy, 18640/10, 18647/10, 18663/10, 18668/10 and 18698/10.
54 French Constitutional Court, 18 March 2015, 2014-453/454 QPC and 2015-462 QPC.
55 Law No. 2016-819 reforming the market abuse enforcement system, 21 June 2016.
56 L465-3-6 of the Financial and Monetary Code.
58 ECtHR, 22 November 1995, S.W. v. the United Kingdom, 20166/92.
59 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.
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.

As for the Public Prosecutor for Financial Matters, it has full discretion to initiate a preliminary investigation and to transmit the file to an investigating magistrate.60 Both the Prosecutor and 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 Court61 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 will be harmonised in the coming months with the six-year statute of limitations applicable in criminal matters.62

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.

### Settlements

Until recently, 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).

Even if settlement of criminal cases is theoretically possible under French law,63 it remains exceptional in practice. A settlement with the victims of the offence is always possible; however, it will only deal with civil damages and avoid any further involvement

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60 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 Paris Criminal Court for trial. This is rarely the case in complex matters, but there are precedents of direct referrals in market abuse cases, which allowed the Paris Criminal Court to rule before the AMF (Salomon, ‘Le principe ne bis in idem et les infractions boursières’, JCPE No. 15, 9 April 2015, 1182).

61 Composed of three judges but no jury.

62 ‘Projet de loi relative à la croissance et la transformation des entreprises’, a bill that is expected to be passed and signed in 2019.

63 Articles 41-2 and 495-7 of the Criminal Procedure Code; Article L465-3-6, X, of the Financial and Monetary Code.
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).\(^{64}\) 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 (\textit{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.\(^{65}\)

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;\(^{66}\) (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.\(^{67}\) This applies to insider trading as well as market manipulation.\(^{68}\)

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 or EEA Member State (other than France), the AMF has jurisdiction for all market abuse infringements committed in France.\(^{69}\)

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.\(^{70}\) The same would be true for an offence entirely committed outside France if the victim was a French national at the time.\(^{71}\)

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

\(^{64}\) Article L621-15 of the Financial and Monetary Code.

\(^{65}\) As a result, it remains difficult to prevent the decision of the AMF Enforcement Committee from being published; however, parties may request that it be anonymised.

\(^{66}\) 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.

\(^{67}\) Unconditional imprisonment of persons convicted for market abuse is rare in France. Indeed, to our knowledge, it has only happened in two cases.

\(^{68}\) Article L465-1 et seq. of the Financial and Monetary Code.

\(^{69}\) Article L621-15 of the Financial and Monetary Code and Article 611-1 of the AMF General Regulation.

\(^{70}\) 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, 92-84745).

\(^{71}\) Article 113-7 of the Criminal Code.
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 application of French law if the loss was incurred in France.

V YEAR IN REVIEW

In 2018, the AMF Enforcement Committee confirmed several times that when the MAR provisions prove to be narrower than the prior AMF General Regulation, and therefore more favourable to the defendant, they have to be applied retroactively. However, the Supreme Court ruled that, while the MAR only places the obligation to disclose inside information on the issuer, the AMF General Regulation may additionally provide that executives shall be sanctioned if the issuer did not comply with its obligations.

In one of its most remarkable decisions of 2018, the AMF Enforcement Committee fined a journalist for having shared that he was about to publish an article covering specific market rumours, which allowed others to trade profitably. The AMF Enforcement Committee ruled that ‘the forthcoming publication of a press article relaying a rumour may constitute insider information’ and that provisions specifically applicable to the press only apply to journalists acting within the scope of their professional duties.

As regards procedural aspects, the AMF Enforcement Committee fined for the first time for obstruction a defendant who had deleted some of his emails during the AMF investigation.

In another case, the Supreme Court ruled that when the Paris Court of Appeal overturns an AMF decision on procedural grounds, the Paris Court of Appeal (if the procedure remains valid nevertheless) may either rule on the merits or refer the case back to the AMF Enforcement Committee. If the Paris Court of Appeal does not opt for one of these two options, the quashing of the decision is final and the AMF cannot resume proceedings.

Another noteworthy topic relates to settlements with the AMF, which were extended to market abuses in 2016 (see Section III.iii). The first settlements in market abuses cases took place in 2017 and this procedure appears to have proven effective, with a similar number of market abuse settlements in 2018. 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 nor a public hearing. According to the AMF, before the settlement was extended to market abuse, almost all defendants accepted settlement when offered.

72 Article 46 of the Civil Procedure Code.
74 Commercial Chamber of the Supreme Court, 14 November 2018, 16-22845.
76 AMF Enforcement Committee, 7 May 2018, SAN-2018-06.
77 Commercial Chamber of the Supreme Court, 24 October 2018, 16-15008.
78 Overall, four AMF settlements related to market abuse have been concluded in 2018 and five in 2017.
VI OUTLOOK AND CONCLUSIONS

One of the European Commission’s key objectives for the years to come is to facilitate the listing of small and medium-sized enterprises (SMEs) (i.e., companies that, according to their last annual or consolidated accounts, meet at least two of the following criteria: an average number of employees during the financial year of less than 250, a total balance sheet not exceeding €43 million and an annual net turnover not exceeding €50 million).

The Prospectus Regulation adopted in 2017 will allow SMEs to follow an alleviated version of the prospectus as from 2019.80 During 2018, in the context of a contemplated ‘Small Listed Company Act’ to be implemented in 2019 or 2020,81 the European Commission released potential amendments to alleviate regulation under the MAR for SME growth market issuers such as (1) limiting insider lists to ‘permanent insiders’, (2) extending the delay to disclose managers’ transactions to the market, and (3) alleviating obligations imposed on issuers when they opt for delaying the publication of insider information. Since those SME growth markets will include not only SMEs but also other issuers, this may result in difficulties by creating discrepancies in the application of the MAR for comparable issuers.82

Besides this commitment to promote the listing of SMEs, national legislatures are considering the implementation of attractive legal frameworks for initial coin offerings. An innovative legal framework will be introduced in France in 2019 and will allow the AMF to carry out an optional supervision, if the issuer so decides, to provide greater security to investors while maintaining as much flexibility as possible to attract issuers.83

Finally, the AMF Enforcement Committee’s Chairman declared that the highest priorities for 2019 will be the prevention of cybercrime on financial grounds, in particular cyber insider trading, and the enhancement of cooperation between national stock markets regulators in investigative procedures, with a view to limiting the impact of Brexit.84

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80 Regulation 2017/1129 of 14 June 2017, of which most provisions will become applicable on 21 July 2019.
83 ‘Projet de loi relative à la croissance et la transformation des entreprises’, a bill that is expected to be passed and signed in 2019.
84 11th symposium of the AMF Enforcement Committee – Address by Marie-Hélène Tric, Chairman of the AMF Enforcement Committee, 3 October 2018.
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 (BGB)) 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;
b the safekeeping of securities is governed by the Custody Act; and
c the Stock Corporation Act includes numerous provisions that apply specifically to public stock corporations. According to modern academic interpretation they form – together with relevant capital market 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. On 3 January 2018, the revised Markets in Financial Instruments Directive (MiFID II)3 has been transposed into German national law, entering into force together with the Markets in Financial Instruments Regulation (MiFIR). The new rules encompass provisions on investor protection, notably 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).

1 Lars Röh is a partner at Lindenpartners Partnerschaft von Rechtsanwälten mbB. Martin Beckmann was also a partner at the firm until April 2019.


3 Directive 2014/65/EU.
In addition, the updated Market Abuse Directive (MAD II)⁴ and a new Market Abuse Regulation (MAR)⁵ became effective in July 2016. MAR has substituted a large amount of national law and establishes a single rule book on market integrity. The new framework applies equally on traditional trading platforms, multilateral (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.

Against this background, the most relevant pieces of supervisory law relating to securities are:

a. 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;

b. 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);

c. the Securities Acquisition and Takeover Act (WpÜG) regulating the takeover and mandatory bids for the acquisition of shares in public companies;⁶ and

d. 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.

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 market disclosure or other abusive behaviour that results in securities holders suffering a loss. There is no specific act that would regulate securities claims. Accordingly, a significant amount of case law has evolved.

The following claims are most common.

Incorrect or omitted publication of inside information

Overview

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

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⁴ Directive 2014/57/EU.
⁶ In spite of its economic importance, the takeover of private companies has not been regulated specifically until now.
publish this information. This provision implements the reasoning of the European Court of Justice in the Daimler case. In addition, Article 17(4) MAR refines the rules on a temporary withholding of inside information by the issuer.

Case law

Until 2002, claims for damages were based on (general) tort law and very often failed to fulfill 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. 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. In later decisions, the BGH refined this line of argument. 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 personal scope of application, which is restricted 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 in about 11 million diesel cars a ‘defeat device’, 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, VW’s preferred share price dropped by 40 per cent. The EPA’s and VW’s statements 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 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 Braunschweig by more than 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 Braunschweig accepted several ‘establishment objectives’ applied for by plaintiffs and VW, and submitted these to the Higher Regional Court of Braunschweig.16 The latter appointed a model plaintiff; following further submissions by the parties a series of oral hearings has been taking place since 10 September 2018.17 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.18 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.19 They were thus to be assigned to the model proceedings at the Higher Regional Court of Braunschweig. Only when these proceedings have been concluded with legal effect would it be possible, to clarify further questions relating specifically to Porsche in separate proceedings. The decision can still be appealed before the BGH.

16 Regional Court of Braunschweig, decision of 5 August 2016 (Case No. 5 OH 62/16).
17 Higher Regional Court of Braunschweig, Case No. 3 Kap 1/16.
18 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).
19 Higher Regional Court of Stuttgart, Case No. 20 Kap 2 – 4/17.
Shareholders v. Hypo Real Estate Holding

The downfall of Hypo Real Estate Holding AG (HRE) is an outstanding example of the impact of the 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 purchase 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.

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.

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 Section 20a WpHG, the predecessor 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.

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.

21 Ibid.
24 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.
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.²⁵ Hence – having bet on falling prices – short sellers suffered severe losses amounting to approximately €10 billion to €15 billion.²⁶

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 a stake of at least 75 per cent in Volkswagen in a series of press communications between March and October 2008.²⁷ However, the Regional Court of Stuttgart rendered a non-guilty verdict in March 2016.²⁸

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.²⁹ The Court further held that Section 20a WpHG would not provide for monetary compensation of investors. The BGH upheld this decision.³⁰ Similarly, the Higher Regional Court of Brunswick reasoned that Sections 37b and 37c 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.³¹

On the other hand, the Higher Regional Court of Celle proceeds with a model proceeding filed by aggrieved investors against Porsche and Volkswagen.³² 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.

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²⁵ For a brief time on 28 October 2008, Volkswagen was the world’s most valuable company.
²⁶ On the facts see Möllers, NZG 2014, pp. 361 and 362.
²⁷ Decision of 18 August 2014 (Case No. 1 Ws 68/14), ZIP 2014, p. 1829.
²⁸ Regional Court of Stuttgart, decision of 18 March 2016 (Case No. 13 Kl 159 Js 69207/09); the judgment is final.
²⁹ 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.
³⁰ Decision of 15 November 2016 (Case No. KZR 73/15), BeckRS 2016, 21465.
³¹ Judgment of 12 January 2016 (Case No. 7 U 59/14), NJW-RR 2016, 624.
³² 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.
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. In this case, a mandatory offer must be published.

Under Section 12 WpÜG, 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. In this respect, debates focus on the question of how to determine whether and when a person has acquired the direct or indirect control over a target company. It must be noted that 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 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 the 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

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33 See Section 29(2) WpÜG.
34 Pursuant to Section 31(1) WpÜG in conjunction with Sections 4 and 5 WpÜG-AngebotsVO (WpÜG Offer Ordinance) the consideration must be ‘reasonable’.
35 On the facts, see Habersack, AG 2008, p. 817 et seq.; and Schanz, DB 2008, p. 1899 et seq.
37 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.
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.38 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.39 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.40 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.41 Finally, the BGH affirmed the view that the attribution of voting rights held 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.42

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.43

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), in the meantime the District Court of Cologne has ruled in favour of other plaintiffs in parallel cases.44

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.45 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.46 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

38 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.
42 BGH, judgment of 29 July 2014 (Case No. II ZR 353/12), NZG 2014, p. 985, Paragraph 39 et seq.
43 See de la Motte and Maisch, ‘Und ab die Postbank’, Handelsblatt, 27 April 2015.
44 District Court of Cologne, decision of 20 October 2017 (Case No. 82 O 11/15).
46 See further ‘Secondary liability’. 
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.47

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 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.48 Mainly for tax reasons, these investments were particularly popular among retail investors and have continued to be so in spite of the fact that some issuing companies went bankrupt. 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.49

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.50 The case law also supports the interpretation of the complex prospectus liability rules set out in Section 306 KAGB.51

47 See Groß, Kapitalmarktrecht (Sixth Edition, 2016), Section 23 WpPG, Paragraph 77 ‘probatio diabolica’.
48 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.
49 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 (Sücker, Rixecker and Oetker (eds.), Sixth Edition, 2012), Section 311, Paragraph 147 et seq.
50 See also Zoller (footnote 48), Section 5, Paragraph 20 et seq. and Section 6.
51 Likewise, see ibid., Section 6, Paragraph 9.
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.\(^52\)

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.\(^53\) 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.\(^54\) 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.\(^55\)

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 is contrary to public policy (Section 826 BGB).\(^56\) 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

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\(^{52}\) 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).

\(^{53}\) Judgment of 6 July 1993 (Case No. XI ZR 12/93) – Bond.

\(^{54}\) 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.


\(^{56}\) In theory, the contract between an issuer and its advisers (e.g., accountants or lawyers) may grant third parties the right to claim damages against the adviser for breaching its obligations under the advisory contract. The courts, however, usually dismiss such assumptions; see Zugehör, NJW 2008, p. 1,105 for a detailed analysis of the case law.
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.

**Summary**

<table>
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<th>Cause of action</th>
<th>Sources of claims for damages</th>
<th>Prominent case law</th>
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| Incorrect or omitted publication of inside information | Sections 37b and 37c WpHG (against the issuer) and Sections 826 and 31 BGB (against the issuer and its managers) | **Infomatec I–II** (BGH, judgments of 19 July 2004 – II ZR 218/03 and 402/02)  
**EM.TV** (BGH, judgment of 9 May 2005 – II ZR 287/02)  
**Comroad I–VIII** (Comroad I: BGH, guidance order of 28 November 2005 – II ZR 80/04)  
**HRE** (OLG Munich, order of 15 December 2014 – Kap 3/10) |
| Market manipulation | Sections 826 and 31 BGB (against the issuer and its managers) | **Infomatec I–II** (BGH, judgments of 19 July 2004 – II ZR 218/03 and 402/02)  
**IKB** (BGH, judgment of 13 December 2011 – XI ZR 51/10)  
**Porsche** (OLG Stuttgart, judgment of 26 March 2015 – 2 U 102/14) |
| Takeover law-related claims | Sections 12(1), 31(1) and 39c WpÜG (against the bidder) | **WMF** (BGH, judgment of 18 September 2006 – II ZR 137/05)  
**Schaeffler/Continental** (BaFin, press release of 21 August 2008)  
**Deutsche Bank/Postbank** (BGH, judgment of 29 July 2014 – II ZR 353/12) |
| Prospectus liability | Sections 21 ff WpPG, Section 306 KAGB and contract law | **BuM** (BGH, judgment of 12 July 1982 – II ZR 175/81)  
**Telekom** (BGH, order of 21 October 2014 – XI ZB 12/12) |
| Wrongful investment advice | Contract law | **Lehman Brothers** (e.g., BGH, judgments of 27 September 2011 – XI ZR 182/10; of 15 October 2013 – XI ZR 51/1; and of 25 November 2014 – XI ZR 169/13) |

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57 See also Paul in KAGB (Weitnauer, Boxberger and Anders (eds.)), Section 306, Paragraph 8.
58 See Section 5(4) WpPG; therefore, banks usually intend to stipulate a hold-harmless agreement with the issuer. See Groß, Kapitalmarktrecht (Sixth Edition, 2016), Section 21 WpPG, Paragraph 17 et seq.
59 Groß (footnote 58), Section 21 WpPG, Paragraph 37 with further references; Wagner in Münchner Kommentar zum BGB (Säcker, Rixecker and Oetker (eds.), Sixth Edition, 2013), Section 826, Paragraphs 75 and 90. The BGH decided that an accounting firm is liable for auditing an unjustifiable profit forecast in a prospectus, judgment of 24 April 2014 (Case No. III ZR 156/13), NJW 2014, p. 2,345.
60 For a more detailed discussion, see Groß (footnote 58), Section 21 WpPG, Paragraph 30 et seq.
61 Groß (footnote 58), Section 21 WpPG, Paragraph 36 with further references; Vokuhl in European Capital Markets Law (Veil (ed.) 2013), Section 17, Paragraph 63.
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 market 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 market 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 market 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. At a conference, a member of the German Ministry of Justice took the view 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.

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 has to 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 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.

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62 Greger in *ZPO* (Zöller (ed.), 32nd Edition, 2018), Section 128 ZPO, Paragraph 1 et seq. and Section 129 ZPO, Paragraph 1 et seq.

63 Section 253 ZPO.

64 Sections 296 et seq. ZPO.

65 Section 278(2) ZPO.

66 Section 279 ZPO.

67 Greger (footnote 62), Section 128 ZPO, Paragraph 10.
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 even remotely resembling subpoena proceedings or disclosure proceedings as they are known in the US legal system. There simply exists no 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 evidences 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 also has to 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

68 Section 138(1) ZPO.
69 Section 358a No. 2 ZPO.
70 Section 142 ZPO.
71 See also Higher Regional Court of Frankfurt am Main, decision of 16 May 2013 (Case No. 20 VA 4/13), BeckRS 2013, 12264.
72 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.
73 Section 138(3) ZPO.
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. 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.

**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 37b and 37c 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.\(^7\)

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 has to 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 4(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).

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\(^7\) BGH, judgment of 13 December 2011 – Case No. XI ZR 51/10.
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).

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.

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.\(^75\)

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

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\(^75\) See also Martiny in *Münchner Kommentar zum BGB* (Säcker, Rixecker and Oerker (eds.), Volume 11, Sixth Edition, 2015) Article 9 Rom I-VO, Paragraph 74 et seq.
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.

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). 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.

**V YEAR IN REVIEW**

Again, *Volkswagen* (see Section I.ii) has been the most outstanding event in the area of securities litigation in Germany.

For the first time since September 2008, when a ban on short selling was imposed on 11 European banks in order to avoid further aggravation from the financial crisis, the BaFin – following critical publications on the payment service provider Wirecard and severe price turbulence at the end of January 2019 – issued a general ruling on 18 February 2019 prohibiting the creation of new net short-selling positions in shares of Wirecard AG or the increase of existing net short-selling positions. As a result, a British hedge fund concerned immediately announced an appeal against the short-selling ban.

In 2018, BaFin revised four sets of topics in its ‘Issuer guideline’ as the first step of a comprehensive update and submitted them for consultation among market participants. On 7 November 2018 it then published the first part of the fifth edition of its Issuer guideline and on 17 December 2018 as Module B (‘Information on significant voting rights/information required for the exercise of rights attaching to securities’) a further part of the fifth edition of the Issuer guideline on its homepage.

For the first time in Germany, a tokenised debt prescription with a securities prospectus approved by BaFin has been offered to the public. A fintech company based in Berlin thus offers private investors the opportunity to acquire a bond with fixed and variable interest using blockchain technology. The bond is placed on a blockchain using cryptographic tokens. No securitisation with a (paper) certificate is effected. The digital token replaces the securitisation and legitimises the holders of the rights from the bond.

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VI OUTLOOK AND CONCLUSIONS

We expect the Dieselgate complex of VW and Porsche to remain the leading case in the coming year. In the model proceedings against VW, parties will file additional statements and applications, which are likely to multiply the volume of the court files and may again jeopardise the timetable for hearings now scheduled to commence in September 2018 (instead of February as previously stated by the court in its initial order).

On the back of the first security token offering (STO) based on a BaFin-approved prospectus (see Section V), it is likely that the STO market in Germany will rapidly grow and, in the aftermath, cause several supervisory and civil law issues related to this particular class of ‘new’ securities.
Chapter 9

ITALY

Giuseppe De Falco and Luigi Cascone

I OVERVIEW

i Sources of law

EU law is the primary source of regulation that directly, or through implementation in national law, shapes the Italian legal framework, and this is also the case in the area of securities law.


Given the primacy of European law in the Italian legal framework, decisions of the European Court of Justice are also of paramount importance in the interpretation and application of EU law and of domestic law implementing EU law.

At a domestic level the main corpus of financial regulation is contained in the Consolidated Financial Act of 1998 (CFA), \(^3\) the Consolidated Banking Act of 1993 (CBA), \(^4\) and in several provisions of the Civil Code, the Criminal Code and, with respect to procedural rules, the Code of Civil Procedure and the Code of Criminal Procedure. With respect to insurance companies and financial products distributed through the insurance market, the Code of Private Insurance \(^5\) and regulations issued by the Italian Insurance Supervisory Authority (IVASS) are also relevant.

Among the secondary sources of law, the most important are regulations issued by the Italian securities and exchange commission (CONSOB) implementing and specifying legal provisions. In addition, CONSOB may also issue guidelines and recommendations.

With the exception of certain Constitutional Court decisions, as in other civil law systems, case law is not sensu stricto a source of law, but the judgment of the Supreme Court and, to a lesser extent of lower courts, is of material importance in the interpretation and application of the law.

Decisions of the European Court of Human Rights may also have an impact on the law.

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1 Giuseppe De Falco and Luigi Cascone are partners at Ughi e Nunziante Studio Legale.
2 MiFID II entered into force on 3 January 2018 in all EU Member States, replacing previous Directive 2004/39/EC (MiFID I).
3 Legislative Decree No. 58 of 24 February 1998.
4 Legislative Decree No. 385 of 1 September 1993.
5 The Code of Private Insurance has been modified by the Legislative Decree 68/2018, through which Italy implemented the EU Directive 2016/97 on insurance distribution.
ii Regulatory authorities

CONSOB is the supervisory authority over investment intermediaries and issuers and is responsible for regulating the Italian securities market and for ensuring compliance with the rules of transparency and proper conduct to protect investors. CONSOB is vested with broad powers to sanction the entities and persons subject to its monitoring authority and, in general, those who may have infringed financial regulations; its powers also extend to the imposition of administrative sanctions in cases of market abuse.

Banca d’Italia is the supervisory authority over Italian banks and financial intermediaries, such as investment firms and collective investment undertakings.

IVASS is the regulatory and supervisory authority over insurance companies and intermediaries and it also has competence for the supervision of the distribution of financial products when performed through typical insurance channels, such as insurance brokers or agents, or directly by the insurance companies.

The Ministry of Economy and Finance (MEF) is also competent to adopt regulations, after consultation with the other regulatory authorities, concerning the experience, integrity and independence requirements for persons in charge of the administrative, management and audit functions in Italian investment companies and asset management companies, and it sets the integrity requirements for the shareholders in such companies.

Italian stock exchange management company Borsa Italiana SpA, which is part of London Stock Exchange Group, is responsible for the management of the exchange market and, as part of its role, monitors the conformity of negotiations on the market and compliance with its rules.

With respect to judicial authorities, civil cases are delegated to local civil courts at first instance, courts of appeal for second instance decisions, and the Court of Cassation (hereinafter also the Supreme Court) as the last recourse for violations of law. For criminal proceedings, the system is more complex. Public prosecutors are in charge of conducting investigations and pleading cases before the criminal courts. The criminal court of first instance has subdivisions that are competent for each particular step of the proceedings, with a judge for the preliminary investigations, a judge for preliminary hearings and the court itself (see Section III.ii).

iii Common securities claims

Civil claims concerning securities include claims brought by small or institutional investors against issuers and their representative bodies for non-compliance with financial regulations, and are normally aimed at obtaining restitution of the investment or damages. More frequently, small investors’ claims are addressed to financial intermediaries and banks responsible for placement and distribution of securities in respect of lack of compliance with information obligations or suitability rules. Typical claims include requests for annulment or termination of investment contracts and restitution of lost investment or damages. Insurance companies – in particular foreign companies operating under the freedom-to-provide-services regime – are also often defendants in cases of substantial losses of securities to which life insurance products are linked (such as unit-linked or index-linked products).

Credit rating agencies are also targeted by claimants for their responsibility in monitoring and rating issuers.

Investors, typically represented by associations, may participate in criminal proceedings to claim civil damages.
II PRIVATE ENFORCEMENT

i Forms of action

The CFA establishes the legal basis for the majority of civil claims brought before Italian courts in securities litigation. It provides a cause of action for untrue or omitted statements in prospectuses, as well as for breach of the public takeover bid obligation for shareholders exceeding the 30 per cent shareholding threshold, for violations of disclosure requirements and the duty of care of financial intermediaries on the secondary market.

Investors are also allowed to sue CONSOB and other third parties, such as rating agencies and auditing firms, for liabilities arising out of violation of the relevant laws and negligence in relation to their supervision and control duties.

In broad terms, under corporate law provisions set out in the Italian Civil Code, namely Sections 2395, 2396 and 2407, investors may seek compensation of their losses by bringing liability claims for breach of legal or corporate obligations of issuers’ or other entities’ directors, managers and auditors. Under Section 15 of Legislative Decree No. 39/2010, statutory auditors and auditing firms may be held jointly responsible with the aforesaid persons for their respective violations.

**Liability for misstatements or incomplete information in prospectuses**

Under Section 94, Paragraph 8 of the CFA an investor may seek compensation in the form of damages from the issuer, the offeror, the guarantor and any other entity responsible for untrue or incomplete statements combined in the prospectus. Investors also have a claim under Section 94, Paragraph 9 against the intermediary responsible for the securities’ placement, where false or incomplete information is capable of influencing a reasonable investor’s decisions.

The Italian Supreme Court has stated in several decisions in recent years that the prospectus liability is a tort that justifies the burden of proof lying with the investor. Nonetheless, alleviations of the burden of proof have been granted for investors by the Supreme Court. In Decision No. 14056/2014, the Supreme Court found that the issuer is to be held responsible where the prospectus is incomplete or misleading because of the issuer’s negligence, unless the issuer proves that the defective information did not influence investors’ decisions. Moreover, the issuer may be exonerated from responsibility upon demonstrating that he or she had performed due diligence to make sure that the prospectus statements were accurate and did not contain misleading information or omit information.

In cases of prospectus liability, investors may bring actions against issuers, directors and managers under Sections 2395 and 2396 of the Italian Civil Code and, based on Section 17 of Legislative Decree No. 39/2010, statutory auditors and auditing firms might be jointly responsible with the audited firm directors and managers for their part of any damage caused.

CONSOB may also be held liable for violation of Section 95 of the CFA, according to which the authority is required to approve the prospectus upon the prior positive test of completeness, consistency and comprehensibility of the information provided therein. However, Decision No. 23418/2016 of the Supreme Court clarified that CONSOB and its employees are to be held responsible only for wilful misconduct or gross negligence (e.g., when it is particularly evident that the information is untrue).

Breach of the obligation to publish a prospectus may also allow the investor to file a claim against the licensed intermediaries to declare the invalidity of the securities purchase contract and restore the loss suffered through the investment.
Actions for prospectus liability are subject to a short limitation period (five years compared with the standard contractual liability statutory period of 10 years).

**Liability for breach of the public takeover bid obligation**

Pursuant to Section 106 of the CFA, anyone exceeding the 30 per cent shareholding or the corresponding voting rights of a listed company (or of a controlling company of a listed company) as a result of acquisitions or voting rights increases must launch a mandatory public takeover bid to all the shareholders of the stock admitted to trading on a regulated market.

Over the past five years, claims have been brought from shareholders seeking damages arising from violations of the public takeover bid obligation. In several decisions on these claims, the Supreme Court repeatedly held that breach of the aforesaid obligation raises contractual liability, and the claimant is entitled to be restored upon demonstration that the missed public takeover bid has resulted in a loss of the possibility of making profits. Pursuant to the Supreme Court case law, damages are calculated taking into account the alternative share value had the public takeover bid been launched, as well as other events capable of influencing the share value.

**Liability for breach of disclosure requirements and other statutory obligations**

In the context of securities litigation, claims regarding contractual relationships between financial intermediaries and retail investors (i.e., investors who do not have sufficient expertise to make informed investment decisions) have been dominating case law over the past 15 years.

The prominence of this kind of dispute is due to different factors, one of which is that the Italian judicial system makes it more likely for investors to obtain monetary compensation on a contractual liability claim against financial intermediaries rather than on claims against issuers or others related to issuers or involved in market placement of securities.

As a matter of fact, the CFA, namely Sections 21 and 23, and the implementing regulations issued by CONSOB, establishes the maximum protection standard for retail investors. These provisions encompass a comprehensive set of disclosure requirements, a general duty of care in the provision of investment services and several obligations concerning the consistency and appropriateness of securities in relation to the investor risk profile (i.e., suitability rule and best-execution rule).

The majority of claims against financial intermediaries have originated from the bankruptcies of well-known Italian firms, such as Cirio and Parmalat, along with the economic collapse of Argentina.

Investors claimed in particular that the intermediaries, on one hand, failed to provide investors with material information on the credit risk of the securities, and, on the other, breached their adequacy-rule obligations, as the securities at stake were not suitable considering the investors’ risk profile. The Supreme Court held that such claims are based on contractual liability but do not affect the validity of contracts between investors and intermediaries. The investor may ask only for compensation for the loss suffered as a result of intermediaries’ breaches. In a recent decision, the Supreme Court also held that the issuer is jointly responsible with the intermediary if the former does not reimburse its bonds, so that the investor is entitled to damage compensation from both the issuer for not reimbursing the bond and the financial intermediary for breach of disclosure requirements or other obligations set out by the law.
According to Section 23 of the CFA, the burden of proving compliance with legal obligations and diligence standards rests with the intermediary. The case law also allows investors to prove causation and damage by mere presumption. Furthermore, no proof at all is requested as to the causation of damage in some cases, such as breaches of the adequacy rule in stock purchase cases.

**Secondary liabilities**

Investors may also bring claims against subjects other than issuers and financial intermediaries. Apart from auditors’ liability mentioned above, investors may sue (1) CONSOB for breaches in licensing, supervision and monitoring of firms and individuals authorised to operate on the securities market, and (2) credit rating agencies for violations of law in performing their credit rating assessment.

As to CONSOB liability, claims on prospectuses mentioned above are embedded in the broader provision under Section 24, Paragraph 6 bis of Legislative Decree No. 262/2005, which sets forth CONSOB’s, and its employees’, liability for unduly exercising with intent or gross negligence its supervisory and monitoring powers. For instance, the Supreme Court held that CONSOB failed in its supervision function by licensing a company that belonged to a larger business group that provided investment services without proper authorisation.

Under Section 35 bis of Regulation (EC) No. 1060/2009 – amended by Regulation (EU) No. 462/2013 – investors and issuers are entitled to seek compensation from credit rating agencies where a credit rating assessment is a result of a violation of legal obligations with wilful misconduct or gross negligence. Credit rating agencies are held responsible if the claimant provides detailed and specific proof both of the breaches committed by the credit rating agency and of the impact of the breaches on the credit rating assessment. There are only two decisions on this subject, both from the Rome Court of First Instance, and both of them rejected the investor’s claim, although they provided useful clarification on how the cause of action applies.

**Class actions**

Class actions may be brought only by consumers and users, that is, individuals acting for purposes other than professional and commercial ones. Section 140 bis of Legislative Decree 206/2005 (i.e., the Italian Consumer Code) provides that consumers acting through their associations and committees may initiate class actions aimed at obtaining damage compensation and refunds.

Section 32 bis of the CFA allows investors to bring collective-interest claims against financial intermediaries. Only associations included on a specific Ministry of Economic Development list are entitled to bring the aforesaid claims. Under Sections 139 and 140 of Legislative Decree No. 206/2005, the remedies provided for such representative associations’ claims include injunctions and measures aimed at correcting or removing negative consequences for consumers caused by counterparties’ violations.

As to the case law, in 2014, the Florence Court of First Instance rejected a class action brought by shareholders against the issuer. The Court held that the claim was beyond the scope of Section 140 bis of Legislative Decree No. 205/2006 for several reasons, one of them being the fact that shareholders cannot be considered consumers.
However, the Supreme Court recently held that Section 140 bis is applicable to individual investors. In Decision No. 23304/2016, the Supreme Court also granted the option to investors’ representative associations included on an ad hoc Ministry of Economic Development list to be a supporting party in claims brought by single investors.

It is worth noting that on 3 October 2018 the Italian House of Representatives, one of the two branches of the Italian Parliament, approved the Draft Law No. 844 regarding the reform of the Italian class action. According to this Draft Law, class actions may be brought not only by consumers and users but by any homogeneous individual rights holders.

The class action would be conducted according to the simpler and faster procedure ruled under Article 702 bis to 702 quater of the Italian Civil Procedure Code. After the decision on the class action is issued, an opt-in procedure would be opened, allowing other people with homogeneous rights to join the action.

However, the Italian Senate must approve this Draft Law in order to actually enact the class action reform.

ii Procedure

The securities litigation claims described above are predominantly common civil claims and are therefore subject to civil proceedings rules set out by the Italian Code of Civil Procedure. Civil proceedings concerning banking, finance and insurance must be preceded by an attempt to settle the dispute through formal mediation proceedings governed by Legislative Decree No. 28 of 4 March 2010. The claimant can then choose either a general civil procedure trial, or, if the claim is relatively simple, to opt for an expedited procedure. The general civil procedure commences with the service of a written statement of claim containing and indicating the hearing for the commencement of the proceedings. The defendant is given a term of not less than 70 days (up to 130 days if the defendant is not resident in Italy) to file his or her written defence. Afterwards, a first hearing takes place, where parties are normally assigned parallel terms within which to submit three corresponding defence briefs containing the definitive presentation of all facts and allegations, and the relevant documents and evidence to support their case. Parties may also request evidence to be produced by the counterparty or third persons, as long as it is assumed that the evidence required is necessary for the claim and may not be achieved otherwise.

As in similar civil law systems, there are no discovery proceedings in the Italian judicial system. A crucial rule in civil proceedings in Italy is that it is up to the parties to select the relevant facts and evidence to be disclosed before the judge. Nevertheless, under Section 210 of the Code of Civil Procedure, parties are provided with the option to request that the judge impose evidence production on the counterparty or others, as mentioned above.

Furthermore, under Section 212 of the Code of Civil Procedure, the judge may request that public bodies file with the court written information on facts and documents that appear necessary for the judgment. Should the judge need assistance to evaluate technical, financial or accountancy issues, an expert of his or her choice may be appointed. This is often the case, for instance, when it is necessary to determine the financial loss suffered by the investor.

Admission and taking of evidence hearings (such as witness hearings) are usually followed by a hearing where parties are invited to make their final requests to the court and followed by a subsequent exchange of final briefs and responses. After this stage, the judge is expected to issue a decision within a short time. A first instance decision becomes definitive if it is not appealed within six months (or in a short term of 30 days if the decision...
is served on the other party), whereas appeal rulings become definitive if not challenged before the Supreme Court (for law violations) within a year (or in a short term of 60 days if the appeal ruling is served on the counterparty).

As a final remark, injunctions, freezing orders and other interim measure proceedings are also available and treated with simpler and more expeditious proceedings.

### iii Settlements

Generally speaking, civil procedure rules provide the judge with the option to attempt an amicable settlement of the claim on his or her own initiative (Section 185 bis of the Code of Civil Procedure) or upon joint request of the parties (Section 185).

Although several provisions on extrajudicial settlement of disputes have been approved by the Italian lawmakers, their application has not been very successful so far. The most important provisions of this kind – and yet the least effective – are laid down in Legislative Decree No. 28/2010, which introduces in broad terms facultative settlement proceedings for civil and commercial disputes conducted by private conciliation and mediation entities. Along with the facultative conciliation, the aforesaid Legislative Decree establishes mandatory pretrial mediation for disputes falling into some subject categories, one of which is financial contracts.

As to the securities litigation sector, since 2017 investors have been provided with a specific settlement entity, namely the Arbitrator for Financial Disputes (ACF). The ACF arbitration board consists of the president and four members, two of whom, along with the president, are nominated by CONSOB, while the remaining two members are appointed by the most representative consumers' associations and financial intermediaries' associations, one by each of them. The ACF has competence for claims not exceeding €500,000 and regarding breaches of disclosure requirements and the duty of care of the financial intermediaries in the provision of investment services to retail investors. Subscription to the ACF is mandatory for financial intermediaries licensed or authorised to operate in Italy. Prior to accessing the ACF, the investor must have submitted a complaint against the intermediary that has not been responded to within 60 days or has been responded to in unsatisfactory terms for the investor. The CONSOB regulation provides for interruption of the ACF proceedings if alternative settlement negotiations are attempted by either party. The decision of the ACF, which is based only on documentary evidence, does not have res judicata effect and cannot be enforced in court. However, should the intermediary fail to comply with an award, it will be subject to reputational sanctions, such as the publication of its breach on the ACF website. According to the ACF first-year activity report, circa 800 rulings were issued by the ACF out of the approximately 1800 claims filed by investors. The ACF approved about 190 claims, granting over €5 million for damages incurred in the provision of financial services. The 2018 annual relation has not been published yet by the ACF.

As to attorneys' fees in the event of settlement, under Section 13, Paragraph 8 of Law No. 247/2012, both parties are jointly obligated to pay the attorneys' fees and expenses if a dispute pending before courts or arbitrators is settled. The joint obligation of the parties may be waived by the attorneys.

### iv Damages and remedies

As a general rule, the claimant is entitled to compensation for loss suffered as a consequence of the defendant's violation.
In prospectus liability cases, the damage for the investor is calculated as a difference between the amount the investor has paid and the amount that would have been actually paid in absence of the alleged violation. In cases of claims against financial intermediaries for breach of their obligations, the damage is quantified as the difference between the securities’ value at the time of the purchase and their value at the time the investor’s claim was filed. Full compensation will be granted in the aforesaid cases if the claimant shows that had the infringement not been committed he or she would have not performed the securities transaction.

In other circumstances, damage consists in loss of opportunity to make profits, namely the higher value of the securities had the breach not taken place, which is the case in the public takeover bid obligation violation.

Indemnification normally encompasses expenses related to the securities transactions. Sometimes, especially in financial intermediary liability claims, judges grant a supplementary compensation for the lost profit of the investor upon demonstration of the alternative use of the amount by the investor or even in a presumptive way.

Punitive damages are not granted, although there is broad debate on the admissibility of this category of damages in the Italian legal system. In this respect, the Italian Supreme Court recently opened the doors to punitive damages, although in the context of the enforcement of a foreign sentence. In fact, in Decision No. 16601/2017 the Court, while excluding the admissibility of punitive damages as a general remedy in the current domestic system, held that punitive damages awarded by foreign judgments may be enforced in Italy, provided that punitive damages cases and applicability conditions thereof are set forth by the law in the state of origin of the judgments.

Although compensation in the form of damages is the main remedy in securities litigation, even the only one in some cases, other remedies for specific claims are provided by law, such as contract termination for gross violations by financial intermediaries, and contract invalidity provided by Section 100 bis of the CFA where an investor bought securities for which a prospectus was required by law and for which the prospectus was not published.

III PÚBLIC ENFORCEMENT

i Forms of action

As a result of the entry into force in July 2016 of MAR (along with the relevant delegated regulations), which is directly applicable and prevails over domestic legislation, a problem arose regarding coordination with domestic legal provisions, in particular those contained in the CFA. In this respect, in a consultation document of 24 October 2016, CONSOB highlighted the relevant domestic provisions – in the CFA in particular – that should be amended or repealed to avoid conflict with MAR and its regulations.

There is a strict connection, and potential overlapping in certain cases, between administrative proceedings and criminal proceedings.

CONSOB is competent for the administrative enforcement of securities law and for imposing administrative sanctions, which are subject to appeal before the judicial authority (courts of appeal). CONSOB is vested with significant investigation powers that, for cases concerning insider trading and market manipulation, may extend to the power to access tax and bank account databases held by other public bodies, to request production of telephone

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registrations, to seize assets that may then be the object of confiscation, although in exercising certain of these powers, which are typical of the judicial authority, prior authorisation of the prosecutor is necessary.

The prosecutor and CONSOB are mutually bound to cooperate and to inform each other about a possible infraction that might lead to either administrative or criminal sanctions. However, to prevent delays to the administrative actions, the latter are not suspended if a criminal investigation or court proceedings have been commenced with respect to the same conduct. CONSOB is also entitled to participate in criminal proceedings to represent the interest of associations and other investors and market representative bodies, and to be awarded damages.

To avoid double sanctions, a specific rule provides that criminal pecuniary sanctions cannot be added to administrative fines and thus only the amount in excess of the latter must be paid by the convicted party. However, the European Court of Human Rights (ECtHR) has highlighted that the Italian sanctions system is likely to infringe the general principle that forbids ‘double jeopardy’ since it is possible that both the administrative and criminal proceedings may be pursued and reach different outcomes.

After the aforementioned ECtHR judgment, the same issue was raised before the Constitutional Court, which, although refusing to examine the case for procedural reasons, considered that the matter was merely procedural in nature, and that it could only be resolved by the intervention of the legislative authority. In this respect, Article 30 of MAR allowed states to avoid administrative sanctions procedures if the same market abuse infringement was considered a criminal offence, but Italy has not used this option to resolve the issue.

ii Procedure

CONSOB procedure is based on the principle of fair trial, transparency and strict distinction between the office in charge of conducting the fact-finding, and the office in charge of imposing the sanction.

However, the Grande Stevens v. Italy ECtHR judgment, in addition to the double jeopardy issue, underlined the lack of due process in a procedure that, while formally administrative, is of a substantially criminal nature.

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6 European Court of Human Rights, in the case of Grande Stevens and Others v. Italy, judgment of 4 March 2014 [Section II]. The Court examined the objection raised by the Italian government as to the obligation to adopt administrative sanctions pursuant to the Directive and observed (Section 229) that ‘insofar as the Government submitted that European Union law has explicitly authorised the use of a double penalty (administrative and criminal) in the context of combating unlawful conduct on the financial markets (see Paragraph 216 above), the Court, while specifying that its task is not to interpret the case law of the Court of Justice of the European Union (CJE), notes that in its judgment of 23 December 2009 in the case of Spector Photo Group, the CJE had indicated that Article 14 of Directive No. 2003/6 did not oblige the Member States to provide for criminal sanctions against authors of insider dealing, but merely stated that those States were required to ensure that administrative penalties were imposed against the persons responsible where there had been a failure to comply with the provisions adopted in implementation of the directive’.

7 Judgment No. 102 of 2016 of the Italian Constitutional Court.

8 See footnote 4.
The Italian Council of State also highlighted the insufficient implementation of the due process principle, imposed by the law, in the procedural regulation issued by CONSOB and the latter was thus obliged to revise its rules in 2015 with a view to enhancing defendants’ rights.

The administrative procedure is commenced through a notice letter addressed to the defendant within 180 days (or 360 days if the defendant has its seat abroad) from the moment in which the CONSOB, in the performance of its supervision activity or in any other manner (for instance, through information transmitted by the prosecutor), finds that a violation might have been committed. The procedure must then be closed within 200 days.

Within 30 days of receipt of the notice, defendants are entitled to present written defences, to file documents and to apply for a personal audition concerning the circumstances of the alleged violation. Defendants may also request to access the documents contained in the official file.

After examination of the file, the competent office also submits to CONSOB a final report indicating a proposal for the kind and amount of the sanction to be issued or for the dismissal of charges. This report is also transmitted to the defendants, but only to the extent they had previously presented written defences or applied for an oral audition.

Defendants are allowed to present a written reply to the report within 30 days. Afterwards CONSOB may adopt the measure, which is served to the defendant, and a summary of which is published in CONSOB’s bulletin.

The sanction may then be challenged before the civil court of appeal within 60 days. The court of appeal, in a procedure that does not entail public hearings,9 decides the appeal and issues a decree that may be challenged, only on legal grounds, before the Supreme Court.

As indicated above, charges such as insider trading and market manipulation must10 also be separately pursued by the prosecutor in accordance with the general rules applicable to criminal proceedings. This means that defendants must be informed about the existence of a criminal investigation any time the prosecutor intends to perform an act entailing the participation of the defendant. The investigation phase is conducted under the supervision of the preliminary investigation judge.

When the investigation phase is closed the prosecutor presents a request for trial or dismissal to the preliminary hearing judge. After the preliminary phase, the case is tried before a court of three professional judges – juries are allowed only for the most serious criminal cases, such as murders – and the judgment can be challenged by the defendant or the prosecutor, or both, before the court of appeal. Second instance decisions are always subject to appeal before the Supreme Court for violations of procedural or substantive law.

Even if not concluded, criminal trials are closed without a decision on the merits if the limitation period applicable to the charge elapses.

As a general comment, criminal proceedings are governed by the adversarial principle and grant to defendants much larger guarantees and rights than the administrative procedure described above, and the burden of proof rests entirely on the prosecutor.

Civil claimants, including associations representing investors and CONSOB itself, may participate in the criminal proceedings and be awarded restitution or damages.

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9 This aspect of the procedure was also criticised by the ECtHR in the Grande Stevens v. Italy decision reported above.

10 Under Italian law, the criminal action is not a discretionary decision of the prosecutor, who is obliged to commence it any time the facts appear to amount to a criminal offence.
Companies may be held liable for market abuse crimes and sanctioned by the criminal court pursuant to Law Decree No. 231/2001 on criminal responsibility of legal entities.

iii Settlements
For a limited number of violations – which do not include insider trading and market manipulation – and within a certain time limit indicated in the notice of infraction transmitted by CONSOB, defendants may avoid liability for a breach of securities law by spontaneously paying an amount equal to double the minimum sanction provided for by the law.\(^{11}\)

In criminal cases, the defendant is generally allowed to apply for a plea bargain before the trial commences. In such cases, the prosecutor may agree or object to the plea bargain, but the final decision is taken by the preliminary hearing judge.

Since a plea bargain does not entail an admission of guilt, any persons who have suffered damage must start a civil case to obtain damages and restitution.

iv Sentencing and liability
For the most serious offences, such as insider trading and market manipulation, CONSOB may impose fines up to €3 million and €5 million respectively. These amounts may be increased up to 10 times the income or profit derived by the defendant as a consequence of the defendant’s violations whenever the maximum fine applicable does not appear to be appropriate in the circumstances. In such cases, in addition to the fine, managers, directors and shareholders of the sanctioned company temporarily lose their honourability entitlements to conduct financial business as professionals (for instance, as financial intermediaries) or, in the case of listed companies, the ability to be appointed as managers and directors of listed companies or of companies controlled by listed companies.

Criminal penalties may include imprisonment from one to six years for insider trading and market manipulation and entail criminal fines up to €5 million. Criminal fines may be increased up to 10 times the profit or gain obtained, taking into account the seriousness of the violation, the quality of the defendant or the amount of the illegal profit or gain obtained. In the case of false information contained in prospectuses to obtain a profit, the sanction may range from one to five years of imprisonment.\(^{12}\)

IV CROSS-BORDER ISSUES
Foreign parties may be subject to the jurisdiction of Italian courts in civil cases (e.g., if, in contractual disputes, a forum selection clause places the competent court in Italy or if the defendant is based in Italy), as well as in the other cases provided for by Regulation (EU) No. 1215/2012 or, when this Regulation is not applicable, pursuant to the general provisions of Italian private international law.\(^{13}\) In disputes involving consumers, however, and in the case of insurance contracts, other grounds to attract jurisdiction in Italy may be invoked (e.g., if Italy is the place of residence of the consumer or of the insured person).

As a general rule (Article 7.2 of Regulation (EU) No. 1215/2012), in tort cases, the competent court is that of the place where the harmful event occurred, which also includes

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\(^{11}\) This option was adopted only in February 2016 with the insertion in the Securities Law of Article 194 \textit{bis}.

\(^{12}\) Article 173 \textit{bis} CFA.

\(^{13}\) Law 31 May 1995, No. 218.
the place where the damage was actually suffered. Based on this rule, to establish their own jurisdiction with respect to a foreign issuer, Italian courts consider it sufficient that the shares of a foreign fund traded in a foreign market be accounted with a depository account of an Italian bank.\footnote{14}{Supreme Court, joint civil sections, 8 April 2011, No. 8034. This interpretation is also consistent with the decision of the European Court of Justice of 28 January 2015 in Case C-375/13.}

In general, in multiparty cases it is often possible to invoke connection of claims and attract foreign defendants before the Italian courts even if the Italian jurisdiction would be excluded by other criteria. This might be the case, for instance, in situations involving intermediaries based in Italy and in which foreign issuers or intermediaries may also be joined based on a potential link of the claim, a joint liability, counterclaims and requests for joinder raised by other defendants.

Crimes and administrative violations are subject to Italian law even if committed abroad, provided that they concern securities listed on an Italian regulated market or for which a request for listing on an Italian regulated market has been filed. In the case of insider trading and market manipulation, the relevant provisions are also applicable when the facts relate to securities listed on regulated markets of other European Union countries.

\section{YEAR IN REVIEW}

The Italian financial market had to deal with another potential threat to its financial stability during 2017, while still implementing the extraordinary measures adopted by the government the former year in order to mitigate the negative impact on the market of the insolvency of four Italian regional banks. The most recent crisis involved two Italian banks (namely, Banca Popolare di Vicenza SpA and Veneto Banca SpA), which are currently subject to compulsory administrative liquidation ordered by the Minister of Economy and Finance and governed by Law Decree No. 99/2017, as amended by Law No. 121/2017. The insolvency proceedings led to the purchase of most of the assets and liabilities of the aforesaid banks by another Italian bank (Intesa Sanpaolo SpA) for the symbolic price of €1, which was made possible by a €5 billion financial contribution, along with additional credit guarantees, granted by the state to the purchaser. This option was justified by the fact that it ensures the maximum level of protection for depositors and account holders, whereas it entails that the crisis costs are borne by shareholders and subordinated bondholders of the banks. The Court of Treviso, upon request of the Public Prosecutor of Treviso, with Decision No. 83/2018 issued on 27 June 2018, declared the insolvency of Veneto Banca SpA.

On 22 September 2018, Law No. 108/2018 entered into force. According to this law, which converted Decree No. 91/2018, people who had invested in securities issued by these banks and filed a claim to the Arbitrator for Financial Disputes (ACF), with a positive decision already issued or to be issued by 30 November 2018, were entitled to have a compensation equal to the 30 per cent of the amount recognised by the ACF, up to a maximum of €100,000.

The ECJ, Fifth Section, with its Decision C-594/16 issued on 13 September 2018, after a request for a preliminary ruling from the Council of State, stated that Article 53(1) of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC
and 2006/49/EC, must be interpreted as not precluding the competent authorities of the Member States from disclosing confidential information to a person who so requests in order to be able to institute civil or commercial proceedings with a view to protecting proprietary interests that were prejudiced as a result of the compulsory liquidation of a credit institution. However, the request for disclosure must relate to information in respect of which the applicant puts forward precise and consistent evidence plausibly suggesting that it is relevant for the purposes of civil or commercial proceedings, the subject matter of which must be specifically identified by the applicant and without which the information in question cannot be used. It is for the competent authorities and courts to weigh up the interest of the applicant in having the information in question and the interests connected with maintaining the confidentiality of the information covered by the obligation of professional secrecy, before disclosing each piece of confidential information requested. As expected, in 2017 some of the most recent EU legal acts regarding the financial sector have been implemented in Italy. In particular, the Italian legislator implemented MiFID II by means of Legislative Decree No. 129/2017, which also embodies some implementing provisions of MiFIR. The major changes imposed on the CFA by MiFID implementation, along with the rules regarding MiFIR, prompted Consob to take several regulatory actions, including the replacement of two important regulations with Regulation No. 20307/2018, which contains detailed rules of conduct and other provisions on financial intermediaries, and Regulation No. 20249/2017, which sets forth provisions that govern the organisation and the activity of the security trading venues.

As previously mentioned, Italy has implemented EU Directive 2016/97 on insurance distribution with Legislative Decree No. 68/2018, which modified some articles of the Code of Private Insurance.

With regard to the unit-linked insurance contracts there are still ongoing conflicting views and decisions among Italian courts. Some of the courts have classified unit-linked insurance contracts as financial contracts, entailing the application of the CFA, while other courts have shared ECJ decisions and acknowledged their insurance nature, excluding, thus, the applicability of the MiFID Directives.

According to the annual index of its bulletin, in 2018 CONSOB imposed 70 administrative sanctions, seven of which concerned market abuse violations.

VI OUTLOOK AND CONCLUSIONS

The approach of Italian claimants to securities litigation, especially with respect to retail investors, has been predominantly addressed to intermediaries, and this trend is likely to increase after the aforesaid implementation of MiFID II, which provides for additional information protection for investors and for strengthened rules of conduct upon financial intermediaries in the provision of their services. However, we do not expect any substantial changes in the case law as to the legal nature of claims and remedies available to investors.

The effort to promote alternative dispute resolution systems, such as mediation and arbitration, has not been particularly efficient so far, with the exception of the semi-adjudicative system of the ACF, which seemed to be more effective and successful in its first year of activity, especially for small claims.

15 Supreme Court, Third Civil Section, 30 April 2018, n. 10333.
16 ECJ, Fifth Section, 1 March 2012, C-166-11; ECJ, Fourth Section, 31 May 2018, C-542/16.
17 The latest decision was issued by the Court of Brescia on 13 June 2018.
Chapter 10

JAPAN

Mugi Sekido, Shinichiro Yokota, Shiho Ono and Yuko Kanamaru

I OVERVIEW

i Sources of law

The sources of securities law in Japan include the Civil Code; the Commercial Code; the Companies Act; and, enacted in 2007, the Financial Instruments and Exchange Act (FIEA), which is the primary source.

The FIEA stipulates the systems for the disclosure of corporate affairs and other related matters, mandates specific matters relating to the financial instruments business and safeguards the appropriate operation of financial instruments exchanges. The FIEA is enforced by the Financial Services Agency of Japan (JFSA) and the Securities and Exchange Surveillance Commission (SESC), a commission that is under the JFSA. Both the JFSA and the SESC periodically issue and update guidelines and regulations relating to the FIEA.

In addition, the stock exchanges in Japan, such as the Tokyo Stock Exchange, the Osaka Securities Exchange, JASDAQ, and Mothers, to name some, also regulate the stock markets, including by issuing disclosure rules. Because each stock exchange has its own rules and regulations, it is important to check the rules of the stock exchange where a company is listed.

ii Regulatory authorities

Securities enforcement actions in Japan are handled mainly by two parties: the SESC and the stock exchanges.

The SESC, the supervising authority of Japan’s financial instruments markets, plays the primary role in maintaining fair, transparent and sound markets. In this regard, the SESC has broad authority to do the following:

a criminal investigations: it investigates criminal allegations of serious offences to determine whether charges should be filed before the public prosecutor’s office;

b administrative monetary penalty investigations: it investigates possible market misconduct, such as insider trading and market manipulation, through on-site inspections and interviews, to determine whether it should recommend the imposition of administrative fines;

c disclosure statements inspections: it inspects disclosure statements for possible violations of disclosure requirements to determine whether it should recommend the imposition of administrative fines;

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1 Mugi Sekido, Shinichiro Yokota, Shiho Ono and Yuko Kanamaru are partners at Mori Hamada & Matsumoto. The information in this chapter was accurate as at May 2018.
financial instruments business operators inspections: it examines financial instruments business operators and other operators for possible violations of laws and regulations and their financial soundness;

day-to-day market surveillance: it collects and analyses information and transaction data from the general public to detect possible violations that may warrant further inspection or investigation; and

filing for court injunction: it inspects FIEA non-registrants’ business for possible violations of laws and regulations. If it finds a violation, it files for a court injunction to prohibit or suspend the act in question and publishes the violator’s name and other information about the violator.

Unlike similar regulatory and enforcement agencies in other countries, the SESC does not have the power to directly prosecute and penalise companies and persons who violate the FIEA and related rules. As can be seen from the brief outline above, the SESC’s powers are largely investigative and recommendatory in nature. Nonetheless, the SESC is an influential entity in enforcing securities laws and regulations. In this regard, the SESC utilises its enforcement tools such as recommendations to impose administrative fines or file criminal charges, the filing of petitions for court injunction and the issuance of policy proposals while it promotes cooperation with self-regulatory organisations and overseas regulators.

In addition to the SESC, the stock exchanges also regulate financial exchange markets. If a stock exchange concludes that a listed company has undermined the confidence of shareholders and investors in the exchange market, it may impose a fine for violating its listing agreement. A typical example of these cases is misstatement.

iii Common securities claims

The most common securities claims in civil cases in Japan are damages claims brought by investors for alleged fraudulent or misleading statements or omissions. While there are also civil cases based on insider trading and market manipulation, they are not as common as misstatements.

Investors can claim for damages arising from misstatements or omission, not only against the issuing company and its executives, including directors and auditors, but also against public accountants and auditing firms who certify, in their audit reports prepared under the Companies Act, that financial statements do not contain any material misstatement or omit material information despite the existence of material misstatements or omissions (Article 21(1)(iii)). The burden of proof that there was no negligence or intent to mislead is on the public accountants and auditing firms. It is, however, difficult to bring a lawsuit against lawyers because there is no specific stipulation in the FIEA that allows investors to claim damages against lawyers.

II PRIVATE ENFORCEMENT

i Forms of action

Securities actions in Japan are usually in the form of damages claims in ordinary civil lawsuits. There are two grounds on which investors may bring damages claims. One is a tort claim based on Article 709 of the Civil Code. The other is Article 21-2 or other provisions of the FIEA.
that may apply under certain conditions. If Article 21-2 is applicable, the plaintiffs (investors) may benefit from the presumption on the amounts of damages under that provision, thereby easing their burden of proof of damages.

The respondents are usually companies that issued the securities in question. Their directors, officers, statutory auditors and accounting auditors (audit firms) may be additional respondents in these actions.

Shareholders may also bring shareholder derivative actions against company directors, officers, statutory auditors and accounting auditors. Shareholder derivative actions, however, are not common, because they are recovery actions on behalf of the issuing company, rather than for the shareholders themselves.

In 2016, new litigation proceedings for consumers’ collective recovery became available. However, these proceedings cannot be used for most securities actions, being available only for consumers who directly acquired securities from the issuing company and have contractual relationships with it. Therefore, it is not available to individuals who acquired securities at stock exchanges.

In securities actions, it is usually difficult for the issuing company to deny liability because such actions are usually brought after a false statement in the company's accounting report is found through a public enforcement proceeding. Such official findings are fundamentally respected in private enforcement proceedings such as civil lawsuits. Therefore, the issuing company usually focuses on reducing damages it may have to pay.

On the other hand, directors, officers, statutory auditors and accounting auditors may challenge their liability by arguing that they could not have found and prevented the false statement. They may also try to reduce the damages claimed against them.

ii Procedure

As described above, securities actions are usually in the form of ordinary damages claims in a civil lawsuit, and there are no specific procedural features that are particular to securities actions.

One of the key characteristics of a Japanese civil lawsuit is periodic hearings, which are held every one or two months. Each hearing usually takes less than 30 minutes, and sometimes they take only a couple of minutes. The aim is to have regular communications among the judges and the parties to establish a mutual understanding of the key points of the litigation. At these hearings, the judges comment on the written brief and accompanying exhibits that are submitted in advance by a party, and suggest to the other party the points that should be covered in the brief that it will submit before the next hearing. This regular communication involving judges is a key element of efficient proceedings in Japan.

Courts easily establish jurisdiction in most security actions because the defendants (i.e., the issuing companies and their directors, officers, statutory auditors and accounting auditors) have Japanese addresses. Therefore, jurisdiction is not likely to be an issue in securities actions. In addition, jurisdiction may also be based on the residences of the plaintiffs (i.e., the alleged victims). Since plaintiffs may reside all over Japan, defendants may face multiple lawsuits all over Japan on the same false statements.

A motion to dismiss is not available in Japanese civil law suits. There are no pleading requirements.

Extensive discovery, as is available in the United States, is not available in Japan. As to document production, parties may seek the production only of specific documents, which
satisfy certain requirements including their necessity to the case. Depositions are not available in Japan, and cross-examinations need to be prepared based on witness statements, which are submitted in advance of witness examinations.

iii Settlements

Japanese civil lawsuits are unique in that the judges in charge of the cases are allowed to be involved in settlement discussions, including ex parte meetings with parties. This is because of the general trust that Japanese citizens have in judges and other public entities. Judges may play an important role in settlement discussions, particularly by expressing their views on the likely outcome of the case.

Settlements are not subject to judicial review in Japan because the parties have the right to resolve their lawsuits. If the parties agree on a settlement term, it will be effective except for in exceptional circumstances, such as the settlement being contrary to public policy.

Generally, losing parties are not liable for the prevailing parties’ attorney’s fees. However, in damages claims, including security actions, the attorney’s fees of the prevailing plaintiffs may be awarded as part of the damages. In practice, the amount of the attorney’s fees awarded as damages is set at 10 per cent of the other damages awarded to the plaintiffs. On the other hand, prevailing respondents cannot recover their attorneys’ fees from the plaintiffs.

d Amends and remedies

Available remedies for securities actions are in practice limited to damages awards. We do not typically see other remedies such as injunctive reliefs sought in securities actions in Japan.

The principle on damages awards under Japanese law is the recovery of the cost of the damage actually suffered by the plaintiffs. Punitive damages are not available under Japanese law.

Article 21-2 of the FIEA presumes the amount of damages, based on (1) the average market value during the month prior to the disclosure date, and (2) the average market value during the month after the disclosure date. The disclosure date means the date of the disclosure of the existence of the false statement in the accounting report, and in our experience the market value substantially drops after the disclosure date. If Article 21-2 of the FIEA is applicable, the plaintiffs may claim the amount calculated by deducting (2) from (1) as damages.

A respondent may challenge the presumed amount of damages calculated above. It will not be liable to the extent that it can prove that all or part of the damage sustained by the plaintiff was because of circumstances other than the decline in the value of the security that could have resulted from the false statement.

For a tort claim, a plaintiff may claim the difference between the purchase price and the sales price (or the current value) of the security as damages if it proves that it would not have purchased the security if the false statement in the accounting report had been known. However, if the decline in the price or market value is partly because of circumstances other than the decline in the value of the security that could have resulted from the false statement, then the portion attributable to the other circumstances should be deducted from the damages to be awarded. Examples of such circumstances include declines because of economic trends, market trends, and business performance of the company. This rule was set by a famous Supreme Court case, the Seibu Railway case.
III PUBLIC ENFORCEMENT

i Forms of action

As explained in Section I.i, both criminal actions and administrative actions could be taken against a potential defendant for violations of the FIEA. See Section III.iv for the major types of actions and possible consequences of those actions.

The SESC has the authority to conduct investigations for criminal prosecution and for administrative enforcement. These investigations are conducted by two principal divisions of the SESC. When the SESC considers bringing cases to the public prosecutor’s office for the filing of criminal charges, the cases are dealt with by the Investigation Division of the SESC. In administrative enforcement cases, it is the Disclosure Statements Inspection Division of the SESC that conducts the inspection and makes recommendations to the SESC to issue an order to impose administrative penalties on a potential defendant. The Investigation Division and the Disclosure Statements Inspection Division sometimes collaborate with each other to a certain extent, but such collaboration is limited because under Japan’s procedural due process, inspections for administrative enforcement must not be conducted for the purpose of filing a criminal prosecution.

The number of cases where the Disclosure Statements Inspection Division of the SESC recommended the imposition of administrative penalties for violations of disclosure rules under the SESC is decreasing slightly, but has basically remained constant in a range of between five and nine cases per year from 2012 to 2016, according to a report published by the SESC in 2017.

ii Procedure

As mentioned above, in cases of administrative enforcement, the Disclosure Statements Inspection Division of the SESC conducts the inspection (FIEA, Articles 26 and 177) and makes a recommendation to the JFSA Commissioner on the imposition of administrative penalties. If the JFSA Commissioner finds a violation, he or she will order the commencement of administrative proceedings (id., Article 178). The administrative proceedings are conducted by a panel comprising three examiners designated by the Commissioner, unless the case is a simple case, in which case the proceedings are conducted by a single examiner (id., Article 180). The examiners are tasked with preparing and submitting to the Commissioner a draft of their decision. The Commissioner will issue an order, based on the draft decision, for the defendant to pay an administrative penalty (id., Articles 185-6 and 7). A lawsuit for the rescission of the order to pay an administrative penalty should be filed within 30 days from the date on which the order comes into effect (id., Article 185-18).

In an inspection by the Disclosure Statements Inspection Division of the SESC, it may instruct relevant persons to report on matters or submit documents concerning the case, and conduct a dawn raid. Although the Disclosure Statements Inspection Division does not have any authority to arrest anyone or to conduct any search and seizure with a warrant, it is difficult in practice to refuse to cooperate in Division inspections because anyone who refuses, hinders, or avoids inspections can be punished by imprisonment for not more than five months or by a fine of not more than ¥500,000, or both (id., Article 205(vi)).

In cases of criminal enforcement, the Investigation Division of the SESC conducts criminal investigations, and if it finds a violation, it will file a criminal complaint before a prosecutor. The Investigation Division does not have the power to arrest anyone, but it can conduct a search and seizure with a warrant issued by a judge of a district court or summary
court that has jurisdiction over the location of the SESC (id., Article 211(1) and (2)). The criminal prosecution of securities-related enforcement actions is subject to the general rules of criminal procedure.

As seen above, in a securities-related enforcement action in criminal cases and administrative cases, the SESC has strong powers to collect evidence and investigate cases, compared with private actions, where extensive discovery as in the United States is not available (see Section II.ii).

iii Settlements

There is no system of settlement between the government and the defendant in administrative actions or criminal actions. However, the Criminal Procedure Code was amended in May 2016. The amendment, which will become effective on 1 June 2018, introduced a new plea-bargaining system in Japan. Under this new system, a prosecutor may enter into a formal plea-bargaining agreement with a suspect or defendant (either a natural person or a corporate entity) who provides certain evidence or testimony in relation to certain types of crimes, including violation of the FIEA, to drop criminal charges or agree to a predetermined punishment. This system is different from the US plea-bargaining system because a suspect or a defendant who only admits his or her own crimes, and not to the criminal acts or liabilities of others, is not entitled to use this plea-bargaining system. A suspect or defendant is required to disclose what he or she knows about the crimes committed by others to have the charges against him or her dropped or reduced or the possible punishment against him or her reduced.

iv Sentencing and liability

Generally speaking, administrative penalties are determined according to calculation methods set by the FIEA, and criminal penalties are determined by courts within the range set by the FIEA by taking into account the seriousness and maliciousness of the violations. The following are examples of administrative and criminal penalties for major types of violations.

**Administrative penalties**

If a company’s annual securities report contains false statements, that company can be punished by an administrative penalty of ¥6 million or 0.006 per cent of the total amount of the value of the company, whichever is higher (FIEA, Article 172-4(1)).

If a company’s Quarterly Securities Report, Semiannual Securities Report, Extraordinary Report or Internal Control Report contains false statements, that company can be punished by an administrative penalty of ¥3 million or 0.003 per cent of the total amount of the value of the company, whichever is higher (id., Article 172-4(2)).

**Criminal penalties**

If a company’s annual securities report contained false statements, any person who submitted that report can be punished by imprisonment of up to 10 years, or a fine of up to ¥10 million, or both (id., Article 197 (1)(i)). If a representative of an entity or an agent, employee, or other worker of a company violated the same rule, both the individual person and the company can be punished by a fine of up to ¥700 million (id., Article 207(1)(i)).

In cases where a company’s Quarterly Securities Report, Semiannual Securities Report, Extraordinary Report or Internal Control Report contains false statements, any person who
submitted that report can be punished by imprisonment of up to five years, or a fine of up to ¥5 million, or both (id., Article 197-2(iv)), and the company can be punished by a fine of up to ¥500 million (id., Article 207(1)(ii)).

IV  CROSS-BORDER ISSUES

i  Private enforcement

Although there is no special law on cross-border securities litigations, a foreign issuer of securities may be sued in Japan if it has its principal office or a business office in Japan or the domicile of its representative or any other principal person in charge of its business is in Japan.

Even if the issuer has no office, director or employee in Japan, it may be sued if the tortious act was committed in Japan. However, depending on the circumstances and amount of damages involved, it may not be effective or worthwhile to bring a suit against such a foreign issuer, given that litigation against a foreign defendant would be time-consuming and costly, and sometimes practically impossible (especially in terms of service of process and the execution of a judgment).

ii  Public enforcement

Japanese courts generally have jurisdiction over crimes committed in Japan. If the criminal act or omission or event relating to a foreign issuer of securities occurred in Japan, the issuer may be prosecuted in Japan.

V  YEAR IN REVIEW

With respect to private enforcement, one of the remarkable decisions relating to securities litigation in 2016 was the decision issued by the Tokyo District Court on 20 December 2016. In this case, an issuer of newly listed stocks had window dressed its financial conditions and the Securities Registration Statement submitted by it contained material false statements. Both the issuer and the security company that acted as the wholesale underwriter for the offering were sued. The court found the underwriter liable for the false statements. Although the FIEA stipulates that a wholesale underwriter may be liable for any false statement on important matters related to a public offering in which the underwriter is involved, this is the first case where an underwriter was found liable.

As to public enforcement, according to statistics on criminal investigations conducted by the SESC, the SESC filed five criminal complaints in 2016: three for market manipulation and two for insider trading. There were no complaints on false statement in 2016, while there were three false-statement complaints in 2015.

VI  OUTLOOK AND CONCLUSIONS

In May 2017, a bill for the amendment of the FIEA was approved by the Diet of Japan, which introduces new rules requiring fair information disclosure by an issuer of listed securities to investors (the Fair Disclosure Rules). The amendment came into force on 1 April 2018. Basically, the new Fair Disclosure Rules require a listed company, etc., to disclose ‘material information’ to the public if a listed company provides such material information to a specific recipient.
As a background of the amendment, in 2016, the Working Group on Corporate Disclosure, one of the Financial System Councils established by the JFSA, issued a report on various matters for the reform of the current corporate disclosure system, including the introduction of fair disclosure rules to ensure fair and timely disclosure. The JFSA established the Task Force on Fair Disclosure Rules, which released a report and proposed the introduction of fair disclosure rules to ensure that when an issuer provides inside information to a third party before its public disclosure, that information is also provided to other investors. Based on the released proposal, the scope of information that would be subject to these fair disclosure rules will include material information that may influence investment decisions, such as information that is subject to the insider trading regulations and other non-public information concerning the issuer of the financial instrument. Note that information that may have an effect on investment decisions when combined with other information, but would have no immediate effect on investment decisions in and of itself will not be within the scope of information that would be subject to the proposed fair disclosure rules. The report stated that the adoption of fair disclosure rules has three positive purposes, as follows:

a. ‘Developing and clarifying disclosure rules that would apply to issuers, which will encourage the prompt disclosure of information by issuers and eventually promote dialogue between issuers and investors’;

b. ‘Laying a foundation for more objective and accurate analyses and recommendations by analysts’; and

c. ‘Promoting changes in the mindset of investors by ensuring a fair timing for the disclosure of information by issuers, to encourage investors to make more investments from a mid- to long-term perspective, rather than just from a short-term perspective, based on the hayamimi information [‘quick-ear’ information]’.
Chapter 11

KOREA

Tony Dongwook Kang

I  OVERVIEW

i  Sources of law

*Primary source*

The primary sources of securities law include 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 Financial Services Commission (FSC), an entity established under the Act on the Establishment, etc., of 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
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 he or she 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.

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Insider trading
The FSCMA provides that if any insider\(^\text{11}\) 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.\(^\text{12}\)

The FSCMA prohibits an insider\(^\text{13}\) 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.\(^\text{14}\) 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.\(^\text{15}\)

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.\(^\text{16}\)

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.\(^\text{17}\)

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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 provision\(^ {20}\) 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**

**i 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

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 any 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\(^35\) 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.\(^36\)

There is no special provision within the FSCMA regarding the calculation method of damages caused by the use of material non-public information.\(^37\) 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 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.\(^38\)

**Market manipulation**

There is no special provision within the FSCMA regarding the amount of damages for market price manipulation.\(^39\) 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

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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’).\textsuperscript{40} 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.\textsuperscript{41}

\textbf{Unfair trading}

There is no special provision within the FSCMA regarding the amount of damages for unfair trading.\textsuperscript{42} 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.

\section*{III \hspace{1cm} PUBLIC ENFORCEMENT}

\textbf{i \hspace{1cm} Forms of action}

Under the FSCMA, the FSC is charged with supervising financial institutions in order 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.\textsuperscript{43} In particular, the FSC (or the SFC) may investigate or cause the FSS to investigate securities-related wrongdoings.\textsuperscript{44}

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).\textsuperscript{45}

\textbf{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.\textsuperscript{46}

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).\textsuperscript{47} 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

\begin{itemize}
  \item \textsuperscript{40} Korean Supreme Court judgment, 2003Da69607, 69614, 28 May 2004.
  \item \textsuperscript{41} Korean Supreme Court judgment, 2013Da11621, 14 May 2015.
  \item \textsuperscript{42} Article 178 of the FSCMA.
  \item \textsuperscript{43} Articles 415 and 419 of the FSCMA, Articles 24, 37 and 38 of the AEFSC.
  \item \textsuperscript{44} Article 426 of the FSCMA.
  \item \textsuperscript{45} Articles 402 and 426(6) of the FSCMA.
  \item \textsuperscript{46} Article 420 (1) of the FSCMA, Article 373 (1) of the Enforcement Decree of the FSCMA.
  \item \textsuperscript{47} Article 429 of the FSCMA.
\end{itemize}
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.49

**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.50 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 in order to prevent such violation.51

### 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.52 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.53 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.54

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).55 In sum, the FSC (or the SFC) may only take the above measures after duly completing relevant procedures.

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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 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.56

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.

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 on any offender who cooperates during the investigation.

iv Sentencing and liability
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:
(1) revoke the financial investment business license or the financial investment business registration; (2) suspend its business entirely or partially for no more than six months; (3) order it to transfer certain contracts to third parties; (4) order it to correct or discontinue violation; (5) order it to publicly disclose or notify of the fact that it is subject to certain sanctions because of its violation; (6) issue a warning; or (7) issue a reprimand.57

Criminal punishment
Criminal punishment for securities-related wrongdoings are as follows under Article 443 of the FSCMA.

56 Article 39 of the RICM, Administrative Appeals Act, and Administrative Litigation Act.
57 Article 420 of the FSCMA.
<table>
<thead>
<tr>
<th>Criminal liabilities</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><strong>Using material non-public information</strong></td>
<td>Imprisonment for up to 10 years or a fine equivalent to one to three times of 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 life or for no less than five years.</td>
</tr>
<tr>
<td><strong>Market manipulation</strong></td>
<td>Punishment shall be aggravated to imprisonment for no less than three years.</td>
<td></td>
</tr>
<tr>
<td><strong>Disseminating a rumour, using a deceptive scheme, violence a threat, with an intention to attempt to fluctuate the market price</strong></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 of 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, 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 manipulation or unfair trading 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

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58 Article 448 of the FSCMA.
59 Article 2 of the FSCMA.
60 Article 176 of the FSCMA.
61 Article 178 of the FSCMA.
Korea (i.e., the personal principle). 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.

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, and the Seoul Central District Court rendered a judgment in favour of the investors on 20 January 2017. 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.

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62 Articles 2 and 3 of the Criminal Act.
64 Korean Supreme Court judgment, 2016Da251, 27 May 2016.
Korea

<table>
<thead>
<tr>
<th>Type of allegation</th>
<th>Number of cases / ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
</tr>
<tr>
<td></td>
<td>No. of cases</td>
</tr>
<tr>
<td>Unfair trading</td>
<td>12</td>
</tr>
<tr>
<td>Market manipulation</td>
<td>54</td>
</tr>
<tr>
<td>Using non-public information</td>
<td>50</td>
</tr>
<tr>
<td>False statement</td>
<td>14</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>132</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 actions 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>Waiting for permission</td>
<td></td>
</tr>
<tr>
<td>Plaintiff (representative plaintiff)</td>
<td>Defendant</td>
<td>Description</td>
<td>Filing date</td>
<td>Date of grant of permission for action</td>
<td>Progress</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>-----------</td>
<td>-------------</td>
<td>-------------</td>
<td>----------------------------------------</td>
<td>----------</td>
</tr>
<tr>
<td>Won-Il 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>Waiting for permission</td>
<td></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>Waiting for permission</td>
<td></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>Waiting for permission</td>
<td></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. Accordingly, judgments relating to securities-related class actions on false statements are expected to be rendered in 2017 or 2018.

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.
Chapter 12

MALAYSIA

Wan Kai Chee and Tan Yan Yan

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 to investors direct recourse 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 this arises in, 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 to investors.

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:

- the claimants are members of a class;
- they have a common grievance or interest; and
- 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 in Malaysia.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.

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2 Section 112 of the Legal Profession Act 1976.
3 Section 348(4) of the CMSA.
action in Malaysia and this could be attributed 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 a 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 action:

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. Civil actions are pursued mainly to deprive the wrongdoers from illegally earned gains and compensate investors. 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. Administrative sanctions are imposed for breaches that require immediate action and remedy. 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.

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

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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.
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

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.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.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 the 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:12

- 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 charged, if any;
- a copy of any document which would be tendered as part of the evidence for prosecution; and
- 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.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.14

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9 See footnote 4.
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.
**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 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 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.\(^\text{15}\) 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.\(^\text{16}\)

**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.\(^\text{17}\)

**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;

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\(^\text{15}\) Section 373 of the CMSA.


\(^\text{17}\) Bursa Securities Annual Report 2013.
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

d 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 being 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;\(^\text{26}\)

\(^{18}\) 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.
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;\(^{27}\)

\(f\) 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;\(^{28}\) or

\(g\) in the case of licensed capital markets intermediaries, refuse renewal of their licence,\(^{29}\) or revoke or suspend their licence.\(^{30}\)

**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 to, among other things, 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)\(^{31}\) and to many bilateral memoranda of understanding with its counterparts in other countries.\(^{32}\) The SC has continuously sought investigative assistance

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27 Section 354(3)(e) of the CMSA.
28 Section 354(3)(f) of the CMSA.
29 Sections 64 and 65 of the CMSA.
30 Section 72 of the CMSA.
from foreign supervisory authorities under the IOSCO Multilateral MOU. In 2018, the SC made 26 requests to eight foreign supervisory authorities, mostly to seek assistance to record witness statements and obtain documents related to banking and securities transactions.\textsuperscript{33} Conversely, during the same year, in response to 10 requests for investigative assistance, the SC rendered assistance to six foreign supervisory authorities.\textsuperscript{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

Significant decisions

\textit{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 amount being 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.

\textit{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 \textit{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.

\textsuperscript{33} SC Annual Report 2018.
\textsuperscript{34} SC Annual Report 2018.
This, among others, 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).

The High Court in the Aldwich case 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 issuer, the issuer's holding company, the substantial shareholder of the issuer and its holding company, the bank, the trustee and the reporting accountant have filed an appeal against the High Court decision.

SC enforcement actions
Based on the SC Annual Report 2018, the SC has taken the following enforcement actions in 2018:

<table>
<thead>
<tr>
<th>Item</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Criminal charges laid</td>
<td>8</td>
</tr>
<tr>
<td>Administrative sanctions imposed</td>
<td>80</td>
</tr>
<tr>
<td>Infringement notices issued</td>
<td>66</td>
</tr>
</tbody>
</table>

As at 31 December 2018, there were 43 active investigations and 51 ongoing cases comprising 15 criminal prosecutions and 36 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

In recent years, the SC has been expanding the scope of things that are legally regarded as ‘securities’, in conjunction with introducing new regulatory frameworks to regulate fintech, such as peer-to-peer lending in Malaysia.

Pursuant to the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019, digital currencies and digital tokens that have specific features are prescribed as securities. Digital currencies and digital tokens that are prescribed as securities are subject to the CMSA, and are regulated by the SC. This would mean that persons who intend to make available prescribed digital currencies and digital tokens will have to seek the prior approval of the SC and register a disclosure document with the SC; persons who carry on a business in dealing in prescribed digital currencies and digital tokens will be subject to the licensing requirements under the CMSA; and digital exchanges will have to be registered with the SC as a recognised market operator.
Chapter 13

NETHERLANDS

Jan de Bie Leuveling Tjeenk and Dennis Horeman

I OVERVIEW

i Sources of law

The sources of Dutch securities law can be divided into civil legislation and (public) financial regulatory legislation.

Civil law

The relationship between the issuers of securities and investors is primarily governed by civil law. The main sources of civil law regarding securities in the Netherlands are:

a the Dutch Civil Code (DCC), providing for, *inter alia*, the rules on contract, tort, causality and damages; and

b the Securities Giro Transfer Act, providing for the rules on ownership, custody and the administration of securities.

Financial regulatory law

The main sources of regulatory securities law in the Netherlands are:

a The Dutch Financial Markets Supervision Act (FMSA) and the various decrees and regulations deriving from it, which include the majority of the regulatory rules that apply to the Dutch financial markets. Many of the rules contained in the FMSA follow from the implementation of European directives.

b The EU Market Abuse Regulation (MAR), which has been in force since July 2016. EU regulations apply directly in all Member States of the European Union. To avoid overlap with other contributions to the *Securities Litigation Review*, we limit our contribution on this Regulation to a few highlights.

c The EU Prospectus Regulation, in effect as of 21 July 2019. Because the regulation has direct effect, most articles on prospectuses will be removed from the FMSA. Only four articles will remain, which include the responsibility for the information in the prospectus and the national regime for exempted offers of securities to the public.

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1 Jan de Bie Leuveling Tjeenk and Dennis Horeman are partners at De Brauw Blackstone Westbroek NV.
2 Wet giraal effectenverkeer.
The Act on the Supervision of Financial Reporting, which forms the basis of supervision by the Netherlands Authority for the Financial Markets (AFM) on financial statements of listed companies and their compliance with the rules on annual accounts as described in the DCC and the International Financial Reporting Standards.

The Economic Offences Act, which criminalises certain violations of the FMSA and other legislation.

Apart from the above-mentioned legislation, a large number of guidelines in relation to securities have been issued by the AFM and the European Securities and Markets Authority.

Lastly, a new Dutch Corporate Governance Code (CGC) was published in December 2016. The CGC contains principles and best practices on the governance of listed companies and their accountability to their shareholders in this area, and operates according to the ‘comply-or-explain’ principle.

**Regulatory authorities**

The AFM is responsible for conduct-of-business supervision on the Dutch financial markets, which aims, among other things, to:

- foster orderly and transparent market processes;
- maintain integrity in the relationship between market parties; and
- protect consumers.

As such, the AFM is the main regulatory authority for the issuers of securities and other parties involved in the issuance of, or trade in, securities, including regulated markets and multilateral trading platforms located or operating in the Netherlands. The Dutch Central Bank (DCB) is responsible for prudential supervision of the Dutch financial markets and as such is less relevant for securities litigation.

In the event of a criminal offence (for instance, an offence under the Economic Offences Act), the public prosecutor is the enforcing authority.

**Common securities claims**

The most common securities claims concern prospectus liability and market abuse.

**Prospectus liability (incorrect or misleading information)**

Prospectus liability claims can be based on various grounds. The FMSA and the EU Prospectus Regulation implementing the Prospectus Directive describe the information a prospectus should contain. Claims can be based on the provisions of the DCC, including the general tort provision, the prohibition on unfair commercial practices (for natural persons not acting as a professional only – i.e., private investors) or misleading advertising.
In case law, the criterion of the probable expectation of an averagely informed, careful and attentive ordinary investor was developed to determine whether information provided to potential investors gave an incorrect or misleading signal.7

**Market abuse**

As of 3 July 2016, the 2014 EU Market Abuse Regulation (MAR) and the related Market Abuse Directive (MAD) replaced the 2003 EU Market Abuse Directive. MAR applies directly in the European Economic Area and includes rules on the disclosure of insider information and insider dealing. MAD has been implemented in Dutch law.

Because MAR is relatively new, no case law has yet been developed under this regulation in the Netherlands. However, a number of proceedings were held under the regime of the 2003 Directive. Most claims regarding market abuse concerned the use of insider information or companies failing to publish insider information.

The AFM is the designated competent authority for the purposes of MAR in the Netherlands. It has the power to impose administrative fines and penalties for infringements of MAR. The public prosecutor can bring charges for criminal sanctions (e.g., fines and imprisonment) if the infringements qualify as economic offences.

**Civil liability claims against regulators**

Since 2012, the FMSA has limited civil liability of the regulators (AFM and DCB) to wilful misconduct and gross negligence.8 This limitation has successfully been invoked in practice.9 Liability claims against advisers of issuers relating to, for instance, annual accounts or prospectuses, are rare in the Netherlands.

In 2000, the initial public offering (IPO) of internet company World Online (WOL) resulted in extensive losses for investors. The Dutch investors’ association – VEB – initiated legal proceedings against WOL, the joint lead managers (as well as the global coordinators and book runners) of the IPO – ABN AMRO Bank and Goldman Sachs – and former shareholders of WOL for providing misleading information. The Dutch Supreme Court ruled that the lead managers were, alongside WOL, liable for the damage caused to the investors, because they did not prevent an unjustified positive image of the issuer from being presented to the investors in the days before the IPO.10

II PRIVATE ENFORCEMENT

i Forms of action

Standard securities claims based on contract or tort are initiated by individual investors before the civil courts. Any form of relief may be sought, such as damages, specific performance of a contract or annulment of a contract.

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8 Section 1:25d FMSA.
9 See for example: Supreme Court, 9 March 2018, ECLI:NL:HR:2018:309, in which the court ruled the DCB was not liable.
Class actions

The Dutch Civil Code allows for the possibility of class actions. Dutch law, however, has a different approach to class actions when compared with common law jurisdictions such as the United States. Under Dutch law, only a representative organisation (in the form of an association or foundation) can start a collective action, and only to protect the interests of a defined group of interested parties or public interests. Such a representative:

a. does not have its own interest in the litigation;
b. does not represent the parties in a formal sense; and
c. is currently not allowed to claim monetary damages.\(^\text{11}\)

As a result, collective actions are used to pursue a declaratory judgment establishing the basis for liability (e.g., a declaration by the court that the defendant committed a tort or breached a contract). On the basis of such a declaratory judgment, parties may claim damages in individual proceedings.

On 16 November 2016, a legislative proposal (the Proposal) was introduced in the Dutch parliament, proposing to amend the existing collective action which would permit representative organisations to claim monetary damages (see Sections II.iii and IV). On 25 January 2019, after several amendments, the Second Chamber of the Dutch parliament adopted the Proposal, and it is currently being discussed by the First Chamber. The Proposal is expected to enter into force in 2019. The Proposal contains a transitory provision and only applies to claims for damage-causing events that have occurred on or after 15 November 2016.

ii Procedure

General securities claims are not subject to a specific procedure, and therefore follow the standard civil procedure. Dutch civil procedural law consists of a written phase in which parties define their positions and, as a general rule, submit all evidence at their disposal that supports their claims. Specific requests to the court (e.g., to hear witnesses or for a neutral expert to be appointed by the court) should preferably already be included at this stage. The written phase is followed by an oral phase, after which, in principle, the court will come to a judgment or allow witness examination or appointment of an expert.

Discovery

Dutch civil procedural law does not provide for discovery comparable to that of the United States, but it does provide for a limited possibility of discovery in cases where a party needs a specific piece of evidence. Parties may request the court to order the opposing party or a third party to hand over or grant access to such evidence.

The court will only order the opposing or third party to share the information if the following conditions are met:

\(a\) the requesting party has a legitimate interest in receiving the information;
\(b\) the information requested is specific (to avoid ‘fishing expeditions’);

c the information requested relates to a legal relationship to which the requesting party is a party; and
d there is no compelling reason to deny the request.12

iii Settlements

The settlement of civil disputes does not require any judicial involvement or review. It is common practice for Dutch courts to suggest, and even recommend, that parties settle their dispute among themselves, even during hearings. If both parties agree to do so, they can disclose to the court the terms of their settlement, upon which the court will make an official transcript of their agreement. This transcript can serve as a title of enforcement if one of the parties does not adhere to the agreed terms of the settlement.

The Proposal amending the legal framework for the collective action aims to make reaching settlements in this type of collective action more attractive (see Sections II.i and IV).

There are no rules regarding the reimbursement of attorneys’ fees in settlements.

The Dutch Act on the Collective Settlement of Mass Claims (WCAM)

A collective action could result in a class settlement certified by the WCAM procedure. The WCAM provides parties to a settlement agreement the possibility of jointly requesting the Amsterdam Court of Appeal to declare the settlement agreement binding. To be entitled to initiate WCAM proceedings, it is not required that a collective action has been filed first. If the court declares the settlement agreement binding, all parties and the persons entitled to compensation are automatically bound by the settlement, unless they opt out in writing within a certain period after the binding declaration. The opt-out period is determined by the court, but it is at least three months.13

Parties are free to agree on the terms and conditions of a class action settlement. However, to qualify for a binding declaration a settlement agreement must:

a meet certain ‘technical’ requirements (e.g., describe the events that lead to the damages and describe the beneficiaries of the settlement); and

b provide sufficient safeguards for the interests of the beneficiaries to justify a binding declaration (such as ‘reasonable compensation’ and a representative organisation being sufficiently representative).14

The WCAM provides that the court will refuse the binding declaration if the compensation awarded in the settlement is not reasonable, having regard to, among other things:

a the extent of the damage;

b the ease and speed with which the compensation can be obtained; and

c the possible causes of the damage and the remuneration structure of representative organisations.

12 Section 843a Code of Civil Procedure.
In cases of mass damages, there is a specific procedure to facilitate pre-litigation settlement. The district court can order a hearing to explore settlement options in such cases. This can be requested by the responsible party or representing organisations, or by them jointly.  

**iv Damages and remedies**

Under Dutch law, as a starting point, the damage has to be determined on the basis of a comparison between the actual situation the aggrieved parties are in and the situation the aggrieved would have been in if the event causing the damage had not taken place. The amount of damages to be paid in respect of contractual and non-contractual claims in the Netherlands can be limited by the requirements of reasonableness and fairness.

The difficulty in relation to securities claims is that, in principle, under Dutch law, the claimant must prove the causal relationship between the actions of the defendant and the losses suffered. On the one hand, this can prove difficult for investors, because their investment decision is usually based on many different factors and most of these factors are difficult to prove. On the other hand, it may often also prove difficult for a defendant to present a defence showing that no causal relationship existed. Case law shows that a relatively high standard applies to the defence showing that the causal relationship is absent. In relation to large-scale financial losses, where the defendant is usually not aware of the individual circumstances of the investor, the Dutch Supreme Court formulated a rule that supports the investor in proving the causal relationship by taking the existence of that relationship as the starting point. Even though the burden of proof is not reversed, the issuer must give concrete facts and circumstances to prove that there was no causal relationship.

### III PUBLIC ENFORCEMENT

**i Forms of action**

Public enforcement of security laws is divided between the financial markets regulators (AFM and DCB) and the public prosecutor. In principle, the financial markets regulators enforce adherence to the FMSA. However, numerous violations of the FMSA are listed as economic offences, making them susceptible to criminal charges by the public prosecutor.

**Public enforcement by the regulator (AFM)**

To enforce compliance the AFM can take both informal and formal action:

*a* The AFM regularly uses informal methods such as entering into discussions about a (perceived) violation of standards or sending a warning letter. Such actions are not arranged for by law, but are common practice and are described in the enforcement policy of the AFM.

*b* The AFM may impose the following administrative sanctions (among others) without prior judicial authorisation:

- order a certain course of action to comply with the FMSA (instruction order);
- order a particular duty, backed by a penalty for non-compliance;
- issue a public warning;

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15 Section 1018a Dutch Code of Civil Procedure.
16 Section 150 Dutch Code of Civil Procedure.
- give an administrative fine; and
- withdraw or limit the licence of a financial undertaking.\(^{18}\)

The financial regulators may request information and seek access to business data and documents. In principle, everybody has a duty to cooperate with the financial regulators. The financial regulators and their employees are subject to a general confidentiality obligation regarding information obtained through their work under the FMSA. However, they may share information with, among others, the Consumer and Market Authority, the tax authorities and the public prosecutor.

**Public enforcement by the public prosecutor**

In the event of a violation of the Dutch Penal Code or in the event of an infringement of securities legislation that is classified as an economic offence, legal entities and individuals can also be prosecuted by the public prosecutor.

**Collaboration between public enforcers**

The financial regulators and other public enforcers (such as the tax authorities and the public prosecutor) can align criminal and administrative processes. This alignment of enforcement actions is based on a covenant aimed at the exchange of information between regulators and the alignment of enforcement, the latter to prevent unwanted interference of administrative law and criminal law. This is based on the principle of *ne bis in idem*.

Public enforcement can inspire a private enforcement claim.

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**Procedure**

**Enforcement by the AFM**

The AFM has the discretionary power to investigate and enforce infringements of the FMSA and other legislation. An enforcement action usually starts well before the determination of a violation by, for instance, an issuer. If the AFM suspects an infringement, it will request information and data from the issuer. Failure to comply with the request may lead to a periodic penalty until the request is met.

If the AFM determines there is a violation of the FMSA, it will send its findings to the defendant in question. The defendant will receive a report including the intention of the AFM to impose a sanction.

A defendant can object to an administrative sanction by the AFM; the AFM must then review its decision in full. If an objection is unsuccessful, a defendant can appeal to the administrative court of first instance. After a decision by the court of first instance, an appeal can be lodged with the administrative court of appeal.

**Enforcement by the public prosecutor**

Criminal prosecution concerning securities law is subject to the standard criminal law procedures before the district court (with a possibility of appeal).

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\(^{18}\) For AFM enforcement figures, see Section V.
iii Settlements
The FMSA does not provide for the possibility of settlements for the AFM. However, it could be argued that the AFM does, in practice, enter into informal settlements. The AFM may, for instance, use its discretionary powers to determine the amount of an administrative fine or the severity of an instruction (within certain limits). It may do so depending on the outcome of discussions with an institution.

The public prosecutor may decide to enter into a settlement with a defendant. A settlement may be entered into either before or after initiating criminal proceedings. Such settlements are not uncommon. In the past few years, we have seen an increase in settlements of large amounts by the public prosecutor, sometimes in collaboration with Dutch and foreign regulators.19

iv Sentencing and liability
The AFM may impose administrative fines after establishing a violation. The amount of the administrative fine imposed depends on the type and severity of the violation and can range from zero to €20 million. An administrative fine may be doubled in the case of a repeat offence. Under the new MAR regime, the AFM can also impose turnover-related fines up to a maximum of 15 per cent of annual turnover.

Irrevocable sanctions by the FMSA, such as an administrative fine or an instruction order, are published by the AFM. The AFM may, under certain circumstances, publish a warning or a decision related to an administrative sanction without having to observe a waiting period. Under normal circumstances, a waiting period of five business days is required. The public prosecutor can request the court to impose a fine, imprisonment or both, depending on the violation and its severity.

IV CROSS-BORDER ISSUES
In relation to cross-border securities litigation, the general rules for cross-border litigation apply. The starting point is that a civil case can be brought before a Dutch court if the defendant has its domicile in the Netherlands (the Brussels I bis regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters). 20 The Brussels I bis Regulation stipulates that a legal entity has its domicile at the place where it has its statutory seat, central administration or principle place of business.21 However, there are a few alternative methods to establish jurisdiction before Dutch courts.

On the basis of the Brussels I bis Regulation, tort claims may be brought before the court in the place where the harmful event occurred.22 In this context, the Kolassa/Barclays Bank case before the Court of Justice of the European Union (ECJ) is noteworthy.23 A consumer domiciled in Austria invested in certificates of Barclays (based in the United

19 See, for example, the settlement between Coöperatieve Rabobank UA on one hand and the DCB, the Dutch public prosecutor, the Financial Conduct Authority (United Kingdom), the Commodity Futures Trading Commission (United States), the American department of Justice and the Japanese Financial Services Authority on the other hand for €774 million in relation to the Libor and Euribor manipulation.
20 Section 4 Regulation (EU) No. 1215/2012 (Brussels I bis Regulation).
21 Section 63 Regulation (EU) No. 1215/2012 (Brussels I bis Regulation).
22 Section 7(2) Regulation (EU) No. 1215/2012 (Brussels I bis Regulation).
23 ECJ 28 January 2015, C-375/12 (Kolassa/Barclays Bank).
Kingdom) through an Austrian bank. Barclays Bank had also distributed a base prospectus in Austria. After the investment sum was largely lost, the investor initiated proceedings before an Austrian court claiming damages relating to the distribution of the prospectus. The Austrian court requested a preliminary ruling from the ECJ on its jurisdiction. The ECJ ruled that, on the basis of where the loss occurred, the Austrian courts had jurisdiction to hear and determine such an action, particularly because the alleged damage occurred directly in the applicant’s bank account. Recently, the Amsterdam Court of Appeal rejected jurisdiction on this basis for lack of an additional connection with the jurisdiction (see Section V).

Claims can also be brought before a Dutch court if parties contractually agree to do so. With regard to proceedings for the binding declaration of international settlements under the WCAM (see Section II.iii), the Amsterdam Court of Appeal assumes jurisdiction rather easily, even if the case is not substantively connected to the Netherlands. In three WCAM cases, Shell, Converium and Ageas, the Court assumed jurisdiction with regard to the shareholders domiciled outside the Netherlands, but within the EU, Switzerland, Iceland or Norway, as their potential claims were ‘so closely connected’ to the claims of the shareholders domiciled in the Netherlands that it was ‘expedient to hear and determine them together to avoid the risk of irreconcilable judgments resulting from separate proceedings’. Furthermore, the Court also assumed jurisdiction with regard to the shareholders who were not domiciled in the Netherlands, or in any other EU Member State, Switzerland, Iceland or Norway, because several petitioners were domiciled in the Netherlands.

The decision by the Court on international jurisdiction in Converium implies that even if the case is not substantively connected to the Netherlands, but a minority of the interested parties are domiciled in the Netherlands, and one of the parties to the settlement is a Dutch entity (for example, a Dutch foundation representing the interests of the alleged victims), the Court will assume jurisdiction.

The WCAM was developed exclusively as a mechanism to offer the opportunity to give a wide effect to settlements reached. The international relevance of the Dutch mechanism for collective settlements has increased and the Netherlands may become a serious alternative for the certification of collective settlements involving non-US investors in non-US securities listed on a non-US stock exchange.

24 Section 25 Regulation (EU) No. 1215/2012 (Brussels I bis Regulation).
28 See Article 8 Section 1 of the Brussels I bis Regulation, see Article 6, Section 1 of the Lugano Convention.
30 As a consequence, the Court also assumed jurisdiction on the basis of the predecessor of Article 7, Section 1 of the Brussels I bis Regulation and Article 5, Section 1 of the Lugano Convention.
V YEAR IN REVIEW

On 23 May 2016, Ageas and a number of representative organisations submitted a request to the Court of Appeal of Amsterdam to declare the global settlement agreement binding with respect to all securities litigation related to the former Fortis group for events that occurred in 2007 and 2008. These events relate, among other things, to the acquisition of parts of ABN AMRO bank. The total settlement amounted to approximately €1.2 billion. After having handed down two interim decisions and amending the settlement to approximately €1.3 billion, the Court declared the revised global settlement binding in July 2018.

Furthermore, on 1 January 2019, the Netherlands Commercial Court (NCC) and the Netherlands Commercial Court of Appeal (NCCA) opened their doors. The NCC and NCCA offer the possibility to litigate in international business disputes (including mass claims) in English before the Amsterdam District Court and the Amsterdam Court of Appeal, making litigation on international mass claims more efficient, effective and attractive.

VI OUTLOOK AND CONCLUSIONS

i Prospectus directive

On 14 June 2017, the Prospectus Regulation was announced. Its main provisions will apply from 21 July 2019.

ii Class actions

The Proposal aims to amend the existing collective action to permit representative organisations to claim damages. The Proposal intends to facilitate collective redress in the form of a collective opt-out mechanism for Dutch claimants and an opt-in mechanism for foreign claimants. It provides incentives to conclude the case with a class settlement. The legislative process is ongoing and an amended proposal was presented to the Dutch parliament on 25 January 2019. The Proposal is expected to enter into force in 2019, and provides for a wide-scope rule for the admissibility of collective actions.

Finally, we note the 'New Deal for Consumers' initiative of the European Commission of 11 April 2018 (COM (2018) 183 final), which envisages an EU-wide collective litigation and settlement mechanism.

32 Regulation (EU) 217/1129.
Chapter 14

NEW ZEALAND

Chris Curran, Marika Eastwick-Field and Nathaniel Walker

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.

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1 Chris Curran, Marika Eastwick-Field and Nathaniel Walker are partners at Russell McVeagh. The authors wish to thank Shannon Closey, Nick Fenton and Freddy Faull 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.
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).  

iii Common securities claims

There have been relatively few proceedings brought under the FMCA since its enactment. However, 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)), which, together with Australian decisions, provide guidance on the likely 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.  

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. One of the key prohibitions in the FMCA is on the offeror making or continuing to make an offer where the product disclosure statement or register entry for a financial product contains false or misleading information or omits required 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:

- the offeror will have strict civil liability for the contravention;

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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 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.

8 *Houghton* (HC – substantive), note 7. 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 7. 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).

9 Sections 82, 99 and 427 of, and Clause 27 of Schedule 1 to, the FMCA.

10 The ‘offeror’ for securities on issue is the issuer.

11 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.

12 FMCA, Sections 82 and 101.

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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;13

c the offeror and its directors can be criminally liable for a knowing or reckless contravention;14 and

d others (e.g., joint lead managers, underwriters and professional advisers) can have civil liability for ‘involvement’ in the contravention15 (or criminal liability as a party to offending).16

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.17 A defendant can rebut this presumption through proof that the decline in value was caused by something other than the relevant statement or omission.18 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:

- that the contravention was because of reasonable reliance on information supplied by another person;19
- 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;20 and
- 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.21

**Fair dealing provisions**

The fair dealing provisions in the FMCA prohibit, generally, misleading or deceptive conduct in relation to financial products and services.22 The making of unsubstantiated representations in relation to financial products or services is also prohibited.23

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13 FMCA, Section 534.
14 FMCA, Section 510.
15 FMCA, Section 533.
16 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.
17 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.
18 FMCA, Section 496.
19 FMCA, Section 499. Note that ‘another person’ does not include a director, employee, or agent of the party in contravention.
20 FMCA, Section 500.
21 FMCA, Sections 501 and 503.
22 FMCA, Sections 17–38.
23 FMCA, Section 23. Note this prohibition does not apply to the content of offer documents – Section 26 of the FMCA.
New Zealand

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) 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. 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. 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, this was the case.

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. The defendant must know or ought to have known their act or omission will, or is likely to, have such an effect. 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. The FMCA deems ‘wash sales’ and ‘matched orders’ to constitute manipulation.

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. An information insider is prohibited from direct trading, disclosing information to others who are likely to trade, or advising or encouraging others to trade in the relevant financial product. The FMCA and regulations provide exemptions to the insider trading prohibitions.

**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

24 FMCA, Section 28.
25 FMCA, Sections 240–269.
26 FMCA, Section 262.
27 FMCA, Section 262.
28 FMCA, Section 265.
29 FMCA, Section 265.
30 FMCA, Section 268.
31 FMCA, Section 267.
32 FMCA, Section 234.
33 FMCA, Sections 241–243.
34 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.
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). The negligence claim was abandoned on appeal.

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’. In criminal securities proceedings, secondary liability will turn on the party liability provision in the Crimes Act 1961 (Crimes Act).

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. 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. 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. 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.

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.\footnote{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 recent reference to the Law Commission in 2017. The Commission has at the time of writing not settled its terms of reference for its class action project, although it is understood by the authors that the project is due to start soon.} 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).\footnote{HCR, Rule 4.24.}

Significant litigation has been brought in this way.\footnote{See, for example, \textit{Houghton} (HC – substantive), note 7, as well as the discontinued proceedings against various retail banks in respect of bank fees.} 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.\footnote{HCR, Rule 4.24.}

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.

\textbf{Derivative actions}

Shareholders can also bring derivative actions under the Companies Act 1993 (CA).\footnote{CA, Section 165.}

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.

\textbf{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.\footnote{The relevant part of the HCR is Part 5.} Private proceedings under the FMCA are ordinary civil proceedings and the usual rules of procedure and evidence apply.\footnote{FMCA, Section 509.}

Claims are commenced when a claimant files a statement of claim and a notice of proceeding in the High Court.\footnote{In some cases, such as derivative actions under the CA, shareholders may first need to obtain leave from the court.} 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.\footnote{HCR, Rule 14.2. Such payment of costs is on a scale rather than an indemnity basis.} 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.\textsuperscript{52} 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;\textsuperscript{53} 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.\textsuperscript{54} These comments may lead to future challenges to litigation funding arrangements. However, the third-party funding of litigation in New Zealand looks likely to be considered by the Law Commission as part of its wider review into class actions, falling within the review’s terms of reference.\textsuperscript{55}

\section*{Representative actions}

The Supreme Court has imposed a relatively low threshold on the ‘same interest in the subject matter’ requirement in representative proceedings.\textsuperscript{56} The relevant HCR (4.24) is interpreted purposively to allow representative proceedings to be a ‘flexible tool of convenience in the administration of justice’.\textsuperscript{57} 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’.\textsuperscript{58}

Representative actions generally proceed on an opt-in basis, with prospective members of the group needing to opt in within a set time period.\textsuperscript{59} 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.\textsuperscript{60} Where not all persons to be represented consent to the proceeding, an application to the court for a representation order is necessary.\textsuperscript{61} Members of a represented

\begin{itemize}
\item[53] 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).
\item[54] PricewaterhouseCoopers v. Walker [2017] NZSC 151 at [100]–[101].
\item[56] 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’.
\item[59] Saunders v. Houghton (No. 2) [2012] NZCA 545, [2013] 2 NZLR 652 at [75].
\item[60] R J Flowers Ltd v. Burns [1987] 1 NZLR 260 (HC) at 264.
\item[61] HCR, Rule 4.24.
\end{itemize}
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.  

The procedure for representative actions, subject to the above, follows typical civil procedural rules.

**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**

There is no general requirement for judicial oversight of an agreement to settle civil securities actions in New Zealand. 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. Notably, court approval of settlements is not expressly required in New Zealand, and if a proceeding is settled, it can simply be discontinued.

Shareholder derivative proceedings brought with leave of the court cannot be settled, compromised or discontinued without approval of the court.

**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.

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63 CA, Section 165(2).

64 CA, Section 168.

65 FMCA, Section 494.

66 FMCA, Sections 494–495.

67 Houghton (HC – substantive), note 7, at [699]–[712]; Houghton (SC), note 7, at [134]–[136].

68 But is likely to be the subject of substantial consideration during the stage 2 hearing in the Houghton v. Saunders proceedings.
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.69

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.70

The FMA can also issue (on an urgent basis, if necessary) orders or notices as follows:

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.71 The FMA can also issue, without notice, an interim stop order pending an exercise of its powers;72

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

69 See FMA Enforcement Policy (August 2016) (available at: https://fma.govt.nz/assets/Policies/160824-enforcement-policy.pdf) and FMA Regulatory Response Guidelines (August 2016) (available at: https://fma.govt.nz/assets/Policies/160824-Regulatory-response-guidelines-policy.pdf). Note that the FMCA also imposes governance obligations on certain entities. For example, Part 4 of the FMCA requires trust deeds for regulated offers of debt securities to comply with specific requirements and imposes legal duties on supervisors to supervise the issuer and to act in the best interest of investors. Part 4 also creates a register of managed investment schemes, including unit trusts and superannuation schemes under which a regulated offer has been made. Security trustees’ compliance with oversight and monitoring obligations has been in the spotlight in New Zealand, particularly following the Supreme Court’s decision in Hotchin v. New Zealand Guardian Trust Company [2016] NZSC 24, [2016] 1 NZLR 906, in which a majority of the court refused to strike out contribution claims by a director of a failed finance company against trustees for allegedly failing to take enforcement action to prevent loss to investors. See also discussion regarding FMA v. Prince & Partners Trustee Company Ltd [2017] NZHC 2059 later in this chapter.

70 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-fernando-ferguson-fsp155185/). The FMA also has powers of designation (including the call-in of financial products) and exemption.

71 FMCA, Sections 462–467.

72 FMCA, Section 465.
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 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:

- exercise and control a right of action on behalf of private litigants, and
- 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. At the highest level of intervention, a contravention of the FMCA coupled with knowledge or recklessness can lead to criminal prosecution by the FMA. The FMA has a policy of publicising enforcement action unless there are policy, legal or other compelling reasons not to do so. This is to maximise the ‘visible deterrence’ and to educate market participants.

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73 FMCA, Sections 468–469.
74 FMCA, Sections 470–471.
75 FMCA, Sections 513–516.
76 FMCA, Section 484.
77 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 66, 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.
78 FMAA, Section 39.
79 FMAA, Sections 44–48.
80 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.
81 FMCA, Section 517. The FMA may also impose conditions on, or revoke, licences.
82 FMCA, Section 480.
85 FMA Enforcement Policy (available at: https://fma.govt.nz/assets/Policies/160824-enforcement-policy.pdf) at [16].
86 FMA Enforcement Policy (available at: https://fma.govt.nz/assets/Policies/160824-enforcement-policy.pdf) at [16].
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.87

The FMA may authorise a specified person to enter and search a place, vehicle, or other thing.88 The search may only occur if the occupier or person in charge consents or a warrant is obtained.89

Civil proceedings

The standard of proof for civil proceedings is the balance of probabilities, and the usual rules of evidence and procedure apply.90 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.91 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.92

Criminal proceedings

The FMA will only take criminal action where there is evidence of intentional, reckless or other serious unlawful conduct.93 Rules governing the FMA’s conduct of criminal litigation are also set out in the Solicitor-General’s Prosecution Guidelines.94

The standard of proof for criminal proceedings is beyond reasonable doubt and procedure is governed by the Criminal Procedure Act 2011.

87 FMAA, Section 25; see also FMA v. ANZ, note 76, at [4].
88 FMAA, Section 29.
89 FMAA, Section 29(3). When the FMA issues an infringement notice, Section 515 of the FMCA sets out the procedural requirements for doing so.
90 FMCA, Section 509.
91 FMA v. Warminger [2017] NZHC 327 [Warminger (No 1)] at [33].
92 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.
**New Zealand**

**Declarations of contravention**

Any person, including the FMA, can apply to the court for a declaration of contravention.95 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.96

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**Collaboration with other regulators**

The FMA has entered into memoranda of understanding with other regulators and agencies.97 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.98

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**iii Settlements**

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.99

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.100 The High Court recently issued the first such approval.101 The Court assessed the settlement in light of the FMA’s objective and functions,102 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.103

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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95 FMCA, Section 486.
96 FMCA, Section 487(1).
98 In particular in relation to consumer credit contracts.
100 FMAA, Section 41.
101 Prince & Partners, note 66.
102 Prince & Partners, note 66, at [8]–[12].
103 Prince & Partners, note 66, 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.104

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:

- the consideration for the relevant transaction;
- three times the amount of the gain made or loss avoided by the contravention; and
- NZ$1 million for an individual or NZ$5 million in any other case.105

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.106

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,107 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 notice108 ranges from NZ$5,000 to NZ$20,000.109 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.110 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.111

104 FMCA, Section 510(3). Lesser sanctions apply for certain criminal offences under the FMCA.
105 FMCA, Section 490.
106 FMCA, Sections 506–507. This extends to fines under the FTA and the Financial Advisers Act 2008.
107 FMA v. Warminger [2017] NZHC 1471 [Warminger (No. 2)] at [13].
108 Infringement notices can be issued for infringement of approximately 30 FMCA provisions.
110 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 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.
V YEAR IN REVIEW

In September 2018, the FMA released its Annual Report for 2017–2018. The FMA had another active year in terms of litigation, pursuing insider trading and failed finance company prosecutions as well as defending judicial review proceedings brought by a major retail bank.

i Insider trading

In September 2018, a High Court jury found a former Eroad executive not guilty of insider trading under Sections 241 and 244 of the FMCA in the first insider trading case to proceed to trial in New Zealand. The executive was retried following an earlier proceeding in March 2018 that had resulted in a hung jury. Mr Sansom’s co-defendant previously pleaded guilty to one charge of insider trading under Sections 243(1)(a) and 244 FMCA in 2017, and was sentenced to six months’ home detention.

The FMA also filed charges Act 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. On 13 March 2019, the executive pleaded guilty to a charge of failing to disclose a relevant interest under Section 19T of the SMA in exchange for the FMA withdrawing its insider trading charge.

ii Further criminal prosecutions

Following a mistrial in May 2017, 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, making false statements as a promoter and making false statements to a trustee. 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.

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. Both were sentenced to four years and six months in prison.

120 FMA v. ANZ, note 76.
124 Crimes Act 1961, Section 220.
125 Crimes Act 1961, Section 242.
126 Companies Act 1993, Section 377(2).
iii Guidance and reports

In 2018 and early 2019, the FMA and RBNZ issued joint reports following 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.\(^{128}\)

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.\(^{129}\)

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.\(^{130}\) The life insurance providers reviewed will also be required to report back to the regulators at the end of June 2019.\(^{131}\)

iv Other matters

Following the placement of CBL Corporation Limited (CBL) into voluntary administration, the FMA announced in July 2018 that it was investigating potential breaches of the FMCA and CA by CBL, its directors and its auditor Deloitte.\(^{132}\) The FMA had earlier filed a case stated procedure under Section 48 of the FMCA in the High Court seeking the Court’s view on whether CBL’s continuous disclosure obligations continued while it was in voluntary administration. This was the first time the FMA had utilised the case-stated procedure. In August 2018, the Court released its decision that the disclosure and reporting obligations of a listed issuer are suspended while that issuer is in administration.\(^{133}\) At the time of writing, the FMA’s investigation into CBL is ongoing.\(^{134}\)

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 the greatest risks of harm to customers and financial markets.\(^{135}\) Market participants who fail to comply with their

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129 FMA/RBNZ Bank Conduct and Culture Review, at pages [6] and [8].
131 FMA/RBNZ Life Insurer Conduct and Culture Review, at page [7].
obligations will receive a response proportionate to the level of harm identified by the FMA. The FMA has also continued to focus on market integrity. It has sought to engage with brokers, managed investment funds who trade securities, and fund managers to reiterate the FMA’s expectation that these organisations should ensure their governance structures, risk-management processes and controls are frequently assessed and reviewed to prevent potential misconduct.

**i  Pending cases**

In October 2017, the FMA filed 47 criminal charges against an individual under the Crimes Act, alleging that he had misappropriated funds deposited by clients. This trial was due to commence in May 2019 at the time of writing.

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.

**ii  Legislation and regulation**

The Financial Services Legislation Amendment Bill (FSLAB) was passed by Parliament on 14 March 2019. FSLAB is an omnibus Bill that proposes amendments to a number of New Zealand Acts, including the FMCA. The Bill largely focuses on changes in regulation of the financial advisory industry, in particular by repealing the Financial Advisers Act 2008 and bringing financial advisers under the ambit of the FMCA. The FMA sees FSLAB 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. The FMCA and regulations will continue to be refined and updated.
The second bill is the Financial Markets (Derivatives Margin and Benchmarking) Reform Amendment Bill, which is currently at the Select Committee stage before Parliament.\textsuperscript{146} Also an omnibus bill, it proposes amendments to 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 Bill 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.

\textsuperscript{146} See Financial Markets (Derivatives Margin and Benchmarking) Reform Amendment Bill (115-1).
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 Securities Commission may issue regulations on matters covered by its duties and powers.

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 downfall of the 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 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.
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. 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 has been amended. For instance, the crime of market manipulation has been amended in order to reflect new types of markets and phenomena, such as benchmarks, emission licences or spot commodity contracts. The crime of insider trading has also been amended and now includes other types of criminal acts, such as the cancellation or the amendment of an order, or the attempt to cancel or amend an order. In addition, the amendments to the Securities Code have 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 was inaccurate or insufficient through the fault or negligence of the financial institution; (2) they suffered real and actual damages; and (3) the damages were caused by inaccurate or insufficient information or a lack of information.

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 does not qualify as an abnormal change 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.

ii Procedure
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.

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 in order 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 has 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 or by the CMVM. 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.

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. It should be noted that 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. 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 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 had 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.

However, the pressure of the 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 of (mostly by investors) 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.

### iii 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 has recently been 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

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3 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.
relevant information in order 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 the 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.

iv 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 last year, 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. In any case, 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 the 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, in order 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 in order 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, the material connection to the 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.
The past few years saw an exponential increase in securities-related litigation in Portugal, with interest-rate swap agreements, the Espírito Santo/Banco Espírito Santo (GES/BES) groups and Banif claiming the limelight.

Numerous cases against banks and financial intermediaries continue to be brought to court by private investors, in particular regarding interest-rate swaps executed before the financial crisis and the resulting tumbling interest rates. Although Portuguese courts have not always been unanimous in their decisions, there is now a general consensus that the effects of the financial crisis do not constitute an abnormal change of circumstance for these purposes (including several decisions of the Portuguese Supreme Court).

In addition, although the Portuguese Supreme Court concluded, in a case from 2015, that a specific swap agreement violated public policy principles and was offensive to good practices and was thus void, having considered that, because there was no underlying asset, the swap agreement was a speculative transaction with no ‘cause’ or justification, later decisions from the Portuguese Supreme Court have since considered that swap agreements, even if speculative, are valid and enforceable under Portuguese law.

On the other hand, the resolution measure applied to bank BES in 2014 continues to be a fruitful source for securities-related litigation. In light of the GES/BES crisis and the consequences of the resolution measure and liquidation proceedings, institutional investors, retail investors, investor associations, shareholders and subordinated creditors brought several civil liability proceedings against BES and its directors and auditors, and against Novo Banco in relation to several types of securities of Espírito Santo Group companies (that were allegedly already insolvent) sold prior to the resolution measure, namely commercial paper and bonds (the liability for which was left with the bad bank). According to news reports, between July and September 2016 alone, around 400 civil proceedings were filed by BES investors against the bank, its directors and the regulatory authorities, and many more have been filed since.

Institutional investors have also brought claims against the regulatory authorities, namely against 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 principle of equal treatment of creditors within their respective rankings); in particular, two class-action suits have been filed by hundreds of BES investors against the Bank of Portugal with a view to challenging the aforementioned retransfer decision. Moreover, Citadel has also challenged the decision, while BlackRock and Pimco, who, jointly, held BES senior bonds worth more than €480 million, have threatened to sue the Bank of Portugal. This litigation is still ongoing, and it is expected to continue in the years to come.

An association for the protection of the bond and commercial-paper investors was created and on 30 March 2016, along with the Portuguese government, the CMVM, the Bank of Portugal and BES signed a memorandum of understanding with a view to finding a solution to minimise the losses of the investors who subscribed to GES’s bonds and

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4 In a landmark case dating back to 2013, the Portuguese Supreme Court held that the abrupt fall in the interest rate constituted an abnormal change in circumstances, on the basis of which the parties had executed the agreement. See decision dated 10 October 2013, proceedings No. 1387/11.5TBBCL.G1.S1.
5 Decision dated 29 January 2015, proceedings No. 531/11.7TVLSB.L1.S1.
Portugal

commercial paper. The incorporation of a fund by means of which the investors shall be partially compensated has now been completed and the fund is currently substituting the private investors in the pending judicial proceedings.

Furthermore, 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 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 a 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.

Several of Banif’s shareholders and bondholders have already filed an action against the Bank of Portugal, the Ministry of Finance, Banco Santander Totta, the Resolution Fund, Oitante (which retained the toxic assets) and the European Commission’s Directorate General for Competition, as well as all of Banif’s and Banco Santander Totta’s directors, with a view to challenging the resolution measure. Further litigation challenging Banif’s resolution measure has since emerged and is expected to continue.

Pursuant to the acquisition by Banco Santander Totta of the majority of Banif’s assets, several investors have initiated securities litigation against Banco Santander Totta, mostly relating to the mis-selling of bonds on the grounds that investors were misled regarding the nature and risks of the securities, or on account of an abnormal change of circumstances caused by the financial crisis.

Lastly, there was a significant increase in litigation regarding bonds issued by Portugal Telecom International Finance BV (PTIF), the company that issued most of the Group PT bonds. In 2015, PT Portugal SGPS, SA was sold to Altice, whereas PTIF remained as a subsidiary of Oi SA. When the Oi group filed for insolvency, the bonds issued by PTIF became worthless. Clients are suing banks for mis-selling the PTIF bonds.

Following the BES’ investors’ example, an association for the protection of the PTIF bond investors has also been created, and in 2018 it announced that it had reached an agreement with InvestQuest, a wealth and asset management company, allowing investors that have not adhered to Oi’s creditors’ plan, holding over about €13,000 in PTIF bonds to sell their bonds at a price equal or superior to 50 per cent of the nominal value.

VI OUTLOOK AND CONCLUSIONS

In recent years, securities litigation in Portugal has been largely influenced by the financial crisis, the GES/BES crisis and the Banif resolution measure, and this seems to be a continuing trend.

On one hand, although the rate of new proceedings related to interest-rate swap agreements has fallen in recent years, the continued lack of consistent decisions by the Portuguese courts is expected to continue, which will give rise to new proceedings being

7 This followed the failed attempt by Banif’s shareholders and its board of directors to sell the bank, and the European Commission’s decision in December 2015 to commence an in-depth investigation procedure into the state aid received by Banif (which could have led to said aid being considered illegal and requiring reimbursement of the aid).
filed. On the other hand, the GES/BES crisis, the Banif resolution and the recent PTIF bond problem have generated a substantial number of disputes in the past few years, most of which are 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 outcome of the litigation against the Bank of Portugal with a view to challenging the retransfer decision by Novo Banco/BES, and the Banif resolution measure, which are also still pending, is mostly likely to shape future litigation in this regard, as well as any resolution measures.

From a regulatory and supervision 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, are currently being discussed and, thus, we expect to see developments in this regard shortly.

Lastly, administrative offences proceedings relating to securities transactions continue to be brought by the CMVM and by the Bank of Portugal against numerous entities, and there appears to be no clear ending in sight.
I OVERVIEW

i Sources of law

The Russian securities market only started developing at the beginning of the 1990s, inspired by mass privatisation in Russia and by the creation of numerous joint-stock companies. The market started its formation 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 rather ‘reactive’ and reflected 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, a 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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Russia

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.

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 a 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:

\[ a \] 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.;

\[ b \] 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.;

\[ c \] administrative liability for abuses relating to insider information and market manipulation;

\[ d \] administrative liability for violation of the rules in respect of depositaries and register holders;

\[ e \] administrative liability for violation of the rules in respect of shareholders’ meetings in public joint-stock companies; and

\[ f \] 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,\(^2\) there were 89 such cases initiated in the period 2010–2018, most of which were for market manipulation (with only three cases for insider trading in 2014 and 2018).

The most common civil law claims in Russia in respect of the securities market may be divided into the following categories:

\[ a \] 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.;

\[ b \] claims invalidating certain transactions;

\[ c \] 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

\[ d \] other claims.

It should be pointed out that 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. Joint actions, although contemplated by Russian legislation, are used extremely rarely in Russian court practice for securities disputes because of the limited legislative guidance and controversial court practice in this field.

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 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 above the 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 intuition’s website. At present, however, there are only three 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.

3 Courts dealing in commercial cases not involving individuals constitute a system of ‘arbitration’ courts (this can be confusing since the arbitration courts are state-run like their counterparts in the west and should not be confused with commercial arbitration bodies that administer private arbitrations by agreement between the parties).
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. 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.

### 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.

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 of 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 of 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 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:

- request documents for investigations in process;
- 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 a 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 the 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 authorities conduct
its own investigation and, depending on the results of a preliminary case assessment, it may
initiate a criminal case.

### Settlements

Settlements in administrative cases are possible as well. The settlement in administrative
proceedings may relate only to rights and obligations of the parties to the dispute (settlement
may not affect 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:

a. 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 reconciled with the injured party and fully compensated the
damage;
the injured party filed a special motion asking for termination of criminal proceedings; and

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:

- the accused individual has never been criminally accused before;
- the accused individual fully compensated the damage done to the injured party; and
- the accused 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:

- 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;

- 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;

- 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;

- 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;

- 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 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;

e. if the damage occurred in Russia; and

f. 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 2019 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.
Chapter 17

SINGAPORE

Vincent Leow and Nicholas Kam

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 summary of the key sources is given 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.
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.

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.

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:

- The SGX-ST Mainboard Listing Manual.
- The SGX-ST Catalist Listing Manual.
- The SGX-ST Rules.
- The SGX-DC Clearing Rules.
- 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 would 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) contract, misrepresentation and breach of fiduciary duties.

The statutory claims are primarily found in Part XII of the SFA. They include:

- Insider trading.
- False trading.
- Market manipulation.
- Market rigging.
- Dissemination of false or misleading statements and information.
- Employment of manipulative and deceptive devices.
Failure to provide continuous disclosure of material information.

Fraudulently inducing persons to deal in capital markets products.

Dissemination of information about illegal transactions.

A breach of the above can attract both civil and criminal consequences. It should also be noted that many of these common securities claims overlap. 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

i Forms of action

Nature of proceedings

Private actions can be commenced by writ or originating summons. The latter is generally limited to actions 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.

ii 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.

**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.

Major legislative amendments to Singapore’s civil procedure regime are expected in the second half of 2019. It remains to be seen how the legislative amendments 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 direct parties to attempt mediation, and if mediation fails, to have the case heard by way of adjudication. The decision of the adjudicator is binding on the financial institution, but not on the retail investor.

### iii Settlements

**Entering into settlement**

The general principles relating to the settlement of a securities claim is 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 any losses suffered.

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 also 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. The general trend 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.

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, as the public prosecutor, it has the power to decide whether or not to commence criminal proceedings. Criminal proceedings involving securities-related offences are similar to 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 instead, 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 be fixed for 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 also 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.

Singapore has recently introduced a deferred prosecution agreement (DPA) scheme. A DPA is a voluntary alternative in 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. This is intended to assist 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 averting costly investigations and litigation. The DPA framework is intended to enable authorities to investigate large-scale, complex corporate crimes, and help bring culpable individuals to justice.

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 also 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 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 does 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 relating to the service of the originating process and the subsequent enforcement of any judgment. In regards to service, leave of the Singapore court would have to be obtained prior to effecting service of the originating process. 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. Similarly, 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 Singapore Securities and Futures Act was recently amended to provide for additional regulatory scrutiny including the protection of safeguards for protecting retail investors as well as the enhancement of regulatory sanctions for market misconduct.

ii Recent judgments

Three cases relating to securities litigation that were recently decided by the Singapore courts are set out below.

The first case (B2C2 Ltd v. Quoine Pte Ltd [2019] SGHC (I) 03) relates to 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 matter was heard in the SICC, which allowed the plaintiff's claims. The Court held that the defendant's reversal of the trades constituted a breach of contract as the parties' agreement was for trades to be 'irreversible'. The Court also held that the defendant was 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.

The second case (Macquarie Bank Ltd v. Graceland Industry Pte Ltd [2018] 4 SLR 87) involved a dispute between a bank and its customer in relation to a commodity swap agreement. This case was heard in the SICC.

The bank's claim arose from its customer's wrongful repudiation of the commodity swap agreement. In its defence, the customer alleged that it had believed that the swap would be effected by the bank as its agent with another third party. Hence, the customer denied the bank's claim on the basis of mistake and that the bank was in breach of its fiduciary duties.

The Court found in favour of the bank. Based on the contractual documentation, the transaction was being entered into between the bank and customer as counterparties. The Court also rejected the customer's claim for breach of fiduciary duties as the bank was not a fiduciary in the first place.
This case serves as a useful reminder that a fiduciary relationship generally arises only if it falls within one of the established categories of relationships or by contract.

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.

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 the 2019–2020:

- 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.

#### 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 2018, FIDReC received 1,251 complaints, higher than in the previous financial year in which 893 complaints were received.
VI OUTLOOK AND CONCLUSIONS

i 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 proceedings are currently ongoing.

ii Payment services

Singapore has been taking steps to build a technologically robust smart financial centre that permits innovation and growth. For example, Parliament has recently passed a new Payment Services Act. The legislation is expected to come into force by the end of 2019 and seeks to provide a forward-looking and flexible framework for the regulation of payment systems and payment service providers in Singapore. It also seeks to provide a dual-track regulatory framework, with one intended for major institutions and the other designed for smaller payment firms (with the threshold being fixed at the average daily float of S$5 million). This is intended to allow smaller payment firms the opportunity to innovate without being subject to all regulations.
Chapter 18

SPAIN

Cristian Gual Grau and Manuel Álvarez Feijoo

I OVERVIEW

i Sources of law

The primary source of securities law in Spain is the Securities Market Act (LMV), approved by Royal Legislative Decree 4/2015 of 23 October.

The current LMV is the product of the consolidation of the previous Act 24/1988 of 28 July, on the Securities Market, which has been amended several times, mostly with the purpose of transposing European Union (EU) directives and other provisions codified in various laws. An example has been the implementation of EU Directive 2014/65/EU (MiFiD II), which entered into force on 3 January 2018. The LMV was recently amended by Royal Decree-Law 14/2018 of 28 September,2 to continue with the implementation of the said Directive, essentially with the purpose of strengthening investor protection by further specifying the information obligations towards them and by assigning new supervisory powers in this respect to the National Securities Exchange Commission (CNMV).

Other subordinated legal provisions regulate in detail certain aspects of the Spanish securities market. These regulations are mainly implemented through Royal Decrees, including Royal Decree 1362/2007 of 19 October on transparency requirements and Royal Decree 2119/1993, which regulates the sanctioning procedure applicable to securities market operators; and Orders issued by the Ministry of Economy and Competitiveness.

The CNMV also issues Circulars for the implementation and enforcement of these legal provisions (e.g., Circular 1/2018 of 12 March on warnings relating to financial instruments).

Additional sources of securities law in Spain include the Civil Code, the Commercial Code, the Criminal Code, the Corporations Act, legislation on the protection of consumers, the Judiciary Act 6/1985 of 1 July, the Civil Procedural Act (CPA) and the Criminal Procedural Act. These are not specific regulations on securities, but they are all relevant in the context of securities litigation.

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1 Cristian Gual Grau is a partner and Manuel Álvarez Feijoo is a counsel at Uría Menéndez. The authors would like to acknowledge the significant contributions of Alba Solano Avelino, Jorge Azagro Malo, Mario Montes Santamaría and Laura Lozano García in the drafting of this chapter.

2 A Royal Decree-Law is a regulation approved solely by the government, which means that despite this norm being already in force, it can be either validated or abolished by Parliament according to Article 86 of the Spanish Constitution.
ii Regulatory authorities

Civil actions involving securities are usually filed with the courts and, although less frequently, before arbitral tribunals. Rulings issued by civil judges or arbitrators are immediately enforceable, regardless of whether they are subsequently appealed. Criminal enforcement proceedings are instigated mainly by Public Prosecutors.

The CNMV is the main domestic regulatory and supervisory authority in Spain. As discussed in Section III, the CNMV is entrusted with inspection and sanctioning powers.

Other important domestic supervisory and regulatory authorities on financial institutions and securities markets are the Bank of Spain, regarding the public debt market, the Ministry of Economy and Competition and the economy departments of some Spanish regions.

Finally, the European Securities and Markets Authority oversees the stability of the EU’s financial system.

iii Common securities claims

The most common civil securities claims in Spain are those filed by non-professional investors against sellers of securities seeking compensatory damages, on the basis of contractual or non-contractual liability, or the annulment of the contract. Lawsuits normally include actions for annulment, termination and damages, with the last two usually being subsidiary claims in the event that the action for annulment is dismissed. Additionally, lawsuits seeking the annulment of unfair contractual terms are also common.

Claims are mainly grounded on the lack of information provided to investors regarding the risks of the investment or the inadequacy of the product for the plaintiff given its previous financial experience and knowledge. Additionally, some recent judgments have been issued on prospectus liability.

Apart from claims against the securities’ issuer and its directors, claims may also be filed against placing agents for breach of information duties during commercialisation. The probability of success in these types of claims must be analysed on a case-by-case basis.

Other forms of secondary liability (e.g., against accountants or directors), although theoretically possible, are less common.

II PRIVATE ENFORCEMENT

i Forms of action

The main actions in securities litigation are those based on contractual liability and those seeking the annulment of the contract entered into by the parties.

While contractual liability is usually claimed on the basis of an alleged fraudulent or defective commercialisation of securities that lead to an error in consent, annulment is claimed on the basis of an infringement of imperative regulations, absence of essential elements of the contract or vices in the plaintiff’s consent (i.e., fraud or error). On different legal grounds, all these actions seek the recovery of the losses derived from financial investments.

3 Criminal claims are discussed in Section III.iv.
4 The error in consent must be essential (i.e., regarding one of the key elements of the contract) and unavoidable (i.e., not avoidable when acting diligently).
Setting aside procedural or material exceptions (e.g., lack of standing, statute of limitations), the main defence against these claims is usually focused on proving that the information provided during commercialisation was complete and accurate and that the financial product was appropriate for the client.

The burden of proof in these actions generally lies with the plaintiff. However, when the plaintiff falls into the category of ‘consumer’, courts have tended to reverse the burden.

Secondary liability claims may be also grounded on non-contractual liability arising from the defendant’s conduct. In these instances, the plaintiff must evidence that the conduct was negligent and that it was the cause of the alleged damage.

ii Procedure

Disputes concerning securities are subject to the standard civil procedure under the CPA. Most cases will fall under the jurisdiction of first instance courts.

Spanish civil procedure has been traditionally adversarial and written phases remain of predominant importance. Standard proceedings are structured in three main phases, with the filing of the statements of claim and defence being the most important. In these briefs, the parties define their positions and, as a general rule, submit all documentary evidence supporting their claims, including expert reports.

The CPA envisages short and non-extendable time limits. Once a lawsuit has been filed, the respondent must submit a statement of defence within 20 working days.

Two hearings are held after the written stage: a preliminary hearing and the trial. In the preliminary hearing, procedural matters, if any, are discussed and the parties propose the evidence on which they intend to rely. Evidence proposed, if accepted by the court, will be examined during the trial, at which the parties will orally submit their conclusions before the case is remitted for judgment.

Spanish law does not envisage a discovery stage comparable to that of the United States. However, rules on access to evidence are being more flexibly interpreted by courts and have been recently broadened by law in certain matters. This may indicate a new trend in civil litigation, more generally. Under the current general framework, parties may petition the court to gather information they may need to file their claim as well as to examine specific pieces of evidence before the trial, or to secure them for examination at a later stage. Once the proceedings have started, the parties are entitled to request that other litigants or third parties produce documents relevant to the case and directly connected to its object.

5 By submitting written evidence (e.g., all the contractual documents signed by the investor as well as the documents and information provided to the investor before and after the execution of the contract) and requesting the seller’s testimony.
6 There could be a preliminary phase in which jurisdictional aspects are discussed if the defendant files a motion to dismiss on those grounds.
8 Article 256 CPA allows for the filing of a request before the court to obtain the necessary information to identify the potential respondent or respondents in the proceedings or individuals that may belong to a class before the filing of a class action.
9 Article 297 CPA.
10 Article 167 CPA.
11 Article 328 CPA.
general, only documents that are relevant to the case and previously identified trigger the duty of disclosure. These requests, which should be limited in scope and nature, must be approved by the court. General petitions of information or documents are not admissible.

Civil procedure in Spain is mainly designed for individual claimants; however, Public Prosecutors and associations of users and consumers have legal standing to file class actions on behalf of groups of individuals that were affected by the same event and whose damage was occasioned by the same cause of action.12 Judgments resulting from class actions will be binding on every individual in a given class, even if they decided to not participate in the proceedings or were unable.13 Unlike in the US legal system, there is no certification of class process under Spanish law or opt-out mechanisms.14 Conversely, the law envisages opt-in mechanisms that allow individuals to join the proceedings at different stages.15

As an alternative to class actions, plaintiffs have resorted to joinder16 or consolidation of multiple cases into a single proceeding when claims are connected.17 Unlike class actions, these judgments only affect the litigants.

Both class actions and joinders are subject to the standard rules of civil procedure.

iii Settlements

Litigants have the right to waive, accept and reach agreements at any stage of the proceedings, unless contrary to an express legal prohibition or where there is a potential harm to third parties or general interests.18 Provided that these restrictions do not limit the parties' right to settle the dispute, courts will approve their settlement agreement,19 bringing the proceedings to an end. There are no specific mechanisms envisaged for collective settlements.

Proceedings may also terminate when the plaintiff's claims are satisfied out of court in a way that leaves the plaintiff without a legitimate interest in obtaining the court's protection. In those cases, the corresponding circumstance must be recorded and the court clerk will order the termination of the proceedings.

No legal costs will be awarded if a settlement agreement has been reached. In these cases, the parties may include legal costs in the object of their negotiations.

When proceedings terminate by means of a judgment, the court will generally order the unsuccessful party to bear the counterparty's legal costs. Should the claimant succeed only partially, then each party will bear its own costs.20 Legal costs include, among others, the fees

12 These individuals are not required to be members of the association filing the complaint and may be determined at a later stage in the proceedings. When the affected individuals are not easily identifiable or are undetermined, associations have exclusive legal standing for the defence of their diffuse interests (Article 11 CPA). Article 15 CPA sets forth different publicity rules depending on whether the class is determined, determinable or undetermined.
13 Article 222.3 CPA.
15 Article 15 CPA.
16 Article 12 CPA.
17 Article 12 CPA.
18 Article 19.1 CPA.
19 Settlement agreements are regulated in Articles 1809–1819 Civil Code.
20 Article 394 CPA.
of attorneys, court agent fees and experts, as well as the travelling expenses of witnesses.\textsuperscript{21} The fees of attorneys and court agents are calculated following the parameters set forth by the corresponding Bar Associations. As such, in practice, not all fees incurred by the successful party may be recovered. Moreover, the CPA creates a general limit on the payable amount of legal fees equal to one-third of the amount in dispute for each of the unsuccessful litigants.\textsuperscript{22}

\begin{itemize}
  \item \textbf{i} Damage and remedies
\end{itemize}

Violations of securities law may trigger compensation for damages when the respondent files a complaint for contractual or non-contractual liability.\textsuperscript{23}

There are no specific rules under Spanish securities law for calculating the amount of damages that should be awarded. However, the general principle is that the harm must be fully repaired. Thus, compensation should include not only consequential damages but also loss of profit.

Generally, the party seeking compensation for damages must prove the existence and the extent of the damages, the respondents’ wilful or negligent conduct and the causal link between the damage and the conduct. As indicated in Section II.i, the burden of proof can be reversed in some instances. However, no compensation for damages can be awarded if one of the previously mentioned elements is not validly evidenced.

When the claimant seeks the annulment of the contract, the granting of the annulment entails reciprocal restitution of compensation between the parties, plus accrued legal interest.\textsuperscript{24}

Other remedies available under Spanish law include specific performance, compulsory performance, withholding of fulfilment, termination of contract and a price reduction. Nevertheless, compensation and restitution are the most frequent remedies in securities litigation.

\begin{itemize}
  \item \textbf{III} PUBLIC ENFORCEMENT
  \item \textbf{i} Forms of action
\end{itemize}

The CNMV is entitled to initiate an administrative procedure that may lead to the imposition of a sanction when an issuer or a market operator violates securities regulations. Sanctions imposed by the CNMV can be appealed before administrative courts.

Nevertheless, the CNMV is not entitled to file a criminal complaint or prosecute securities-related crimes. If, in the course of its supervisory activity, the CNMV finds indications of a criminal offence, it must refer the case to the Public Prosecutor. The CNMV will not be a party to the criminal proceedings, but will assist the prosecutor and the court by producing documentary evidence or issuing expert opinions.

Criminal enforcement of securities regulations has recently been enhanced by an amendment to the Criminal Code that entered into force in March 2019. Through this amendment, Spain has transposed Directive 2014/57/EU of the European Parliament and

\begin{itemize}
  \item Article 241 CPA.
  \item Article 394 CPA.
  \item Articles 1101 and 1902 Civil Code.
  \item The ‘legal interest’ is set by law (currently 3 per cent).
\end{itemize}

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the Council, of 16 April 2014, on criminal sanctions for market abuse. It has also clarified what conduct qualifies as market abuse and manipulation and insider trading offences, while keeping corporate criminal liability for securities-related crimes.

ii Procedure

Enforcement actions may be divided into two main categories: administrative proceedings conducted by the CNMV and criminal proceedings pursued mainly by the Public Prosecutor before the criminal courts.

Administrative sanctioning proceedings are initiated by the CNMV ex officio. The resolution of initiation will be notified to the defendant, who may file written allegations. The CNMV’s Legal Affairs Department acts as the investigative body and is entitled to perform all necessary fact-finding tasks. In view of the initial findings, the investigative body will issue a preliminary statement of charges against the defendant, who will have 20 days to reply. Once the investigation is concluded, the investigative body will issue a motion for a resolution, regarding which the defendant will have 20 days to submit objections or comments.

After this time, the investigative body will refer the motion to the board of the CNMV, which is the competent authority to resolve sanctioning procedures. The board of the CNMV may take additional investigative measures before issuing its decision. Decisions (sanctions) issued by the board of the CNMV may be appealed to the Minister of the Economy. In turn, decisions by the Minister of the Economy may be appealed before an administrative court (the National Court in Madrid).

The duration of an administrative proceeding is limited to one year from the date of the decision to initiate the proceeding. Simplified proceedings (limited to four months) are available for minor infringements or cases in which the facts have been fully disclosed.

It is noteworthy that securities issuers and market operators are legally bound to cooperate with the CNMV during its investigations by disclosing and providing all requested information and documentation deemed necessary for the administrative proceedings. Refusal to cooperate with the CNMV is classified as a very serious administrative infringement.

As regards criminal enforcement, there is no special criminal procedure for the prosecution of securities-related crimes. Therefore, standard criminal procedure is applied.

Criminal proceedings under Spanish law are divided into three stages: the investigation stage, the accusation stage and the oral trial or hearing. The investigation stage is aimed at investigating the alleged crimes and the alleged perpetrators (both legal and natural persons) to allow the investigating judge to decide whether the case should be dismissed (if there are insufficient grounds) or tried (if there are sufficient indications that a crime has been committed by the alleged perpetrators). The accusation stage is an intermediate step between investigation and trial during which the parties (the prosecutors and defendants) file their respective briefs of accusation and defence. In the oral trial, prosecutors attempt to establish the facts and guilt of the accused parties (whether natural or legal persons).

25 Under Spanish law, criminal prosecution may be initiated and held:

a by means of a criminal complaint filed by the Public Prosecutor (roughly equivalent to a state attorney in the United States);

b by means of a criminal complaint filed by private individuals. Private prosecution may only be initiated by those who have a direct interest in the facts (e.g., a victim or aggrieved individual); or
The standard of proof depends on the procedural stage. In the investigation and accusation stages, prosecutors must provide the criminal court with sufficient indications (not evidence) that a crime may have been committed by the suspect so that an oral trial can be held. If there are insufficient indications of criminal activity, criminal proceedings will be dismissed at this stage. In the oral trial, the accused legal or natural person can only be declared guilty if criminal liability is proved beyond a reasonable doubt.

As regards discovery in criminal cases, parties may propose any investigative measure they deem necessary; however, the investigating judge has sole authority to order the measures (e.g., depositions, searches and seizures, wiretapping and document discovery). Unlike in administrative procedures, suspects have no obligation to cooperate with the court or the Public Prosecutor or to produce evidence.

iii Settlements

Unlike in other administrative proceedings, administrative sanctioning procedures involving securities do not allow settlements (or findings of conformity) between the defendant and the authorities concerned (in this case, the CNMV). The only possibility available to the defendant is to fully recognise and admit the infringement and redress it at its own initiative to the extent possible. Both the admission of liability and redressing actions are factors taken into account by the competent body when deciding to impose a less severe penalty within sentencing guidelines.

As regards criminal procedures, under Spanish law, public prosecutions are governed by the principle of mandatory prosecution (linked to the principle of legality). As a consequence, a Public Prosecutor is not entitled to drop or defer prosecution in the context of a settlement as long as there are indications that a crime has been committed.

However, the Criminal Procedure Act allows parties in criminal proceedings to enter into plea bargain agreements at any time before the oral trial is finished, except if the requested penalty exceeds six years of imprisonment. All securities-related crimes are subject to plea bargains given that none is punishable by a sentence exceeding six years.

A plea bargain consists of an agreed acceptance by the defendants (either legal or natural persons) of the charges, counts and penalties brought by the prosecutor before the criminal court. As a consequence, the criminal court issues a judgment in accordance with the mutually agreed penalties and damages, which are imposed on the defendants. The criminal court may only refuse to issue a judgment on those terms if:

\[ a \] there exists some doubt that the accused’s decision to enter into the bargain was taken under duress;

\[ b \] the defendant’s attorney deems it necessary to hold the trial; or

\[ c \] the court believes that the prosecution’s charges and counts contravene the law or that the sentencing requested is inappropriate.

The plea-bargain judgment may only be appealed if it does not comply with the terms of the agreement.

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c by means of a criminal complaint filed by ‘people’s prosecutors’. The people’s prosecution may be held by any individual or entity that, regardless of their involvement in the facts, seeks to prosecute a crime.
The general rule regarding attorneys’ fees in criminal proceedings is that the convicted party is responsible for all legal costs (including attorneys’ fees) of the claimants (private prosecutors). As a particular feature, procedural costs may only be imposed on private prosecutors where it is established that they have acted recklessly or in bad faith.

iv  Sentencing and liability

The LMV classifies administrative infringements as minor, serious or very serious, establishing different sanctions for each class of infringement.

Very serious infringements are punishable with a fine amounting to the highest of the following figures: five times the amount of the gross profit made or the loss avoided as a result of the infringement; 5 per cent of the shareholders’ equity of the offending entity; 5 per cent of the offending entity’s or of third parties’ funds used to commit the infringement; 10 per cent of the offending entity’s annual turnover; or €5 million. In addition to the fine, other sanctions may be imposed, such as:

a  suspension or limitation of the type or volume of transactions and activities that may be undertaken by the offender in securities markets for up to five years;

b  suspension from membership in an official secondary market or a multilateral trading facility for up to five years;

c  removal of a financial instrument from trading on a secondary market or a multilateral trading facility; or

d  withdrawal of authorisation to trade.

Serious infringements are punishable with a fine amounting to the highest of the following figures:

a  three times the amount of the gross profit made as a result of the infringement;

b  2 per cent of the shareholders’ equity of the offending entity;

c  2 per cent of the offending entity’s or of third parties’ funds used to commit the infringement; or

d  €300,000.

In addition to the fine, other sanctions may be imposed, such as:

a  suspension or limitation of the type or volume of transactions and activities that may be undertaken by the offender in securities markets for a period of up to one year;

b  suspension from membership in an official secondary market or a multilateral trading facility for a period of up to one year; or

c  withdrawal or suspension of the authorisation to trade for up to five years.

Minor infringements are punishable with a fine of up to €30,000.

Article 310 of the LMV sets forth the criteria for calculating fines, such as the nature and severity of the infringement, the degree of responsibility and the financial strength of the offender, the seriousness and duration of the hazard or damage caused, the losses caused to third parties, the profit obtained or the loss avoided or the fact that the offender redressed the infringement at his or her own initiative.

26  Articles 278 to 289 ter and 302 LMV.
27  Articles 291 to 299 and 303 LMV.
28  Articles 300 and 305 LMV.
After its 2019 amendment, the Criminal Code foresees the following securities-related criminal offences:

- **investment fraud**;
- **market abuse and manipulation**;
- **insider trading**;
- **unlawful disclosure of inside information**; and
- **incitement and conspiracy to commit market abuse and manipulation, insider trading and unlawful disclosure of inside information**.

**Investment fraud**

Article 282 *bis* of the Criminal Code punishes the directors of a securities issuer that forge the prospectus of an initial public offering (IPO) of shares or any other mandatory statements or periodic reports to unlawfully obtain investments. No loss need be incurred by any investor for a crime to have been committed. This offence is punishable by imprisonment of between one and four years. If a loss is caused to an investor, the punishment imposed will fall within the upper half of that range (imprisonment of two-and-a-half to four years). In addition, if the damage caused is particularly serious, the penalty will range from between one and six years’ imprisonment and a fine of between €360 and €144,000.

**Market abuse and manipulation**

Article 284 of the Criminal Code punishes three different conducts of market abuse and manipulation:

- **alteration of prices by using violence, intimidation, deceit or any other form of contrivance**;
- **alteration of prices of a financial instrument or a related spot commodity contract and manipulation of a benchmark by spreading false news or rumours, if the offender obtains a profit, provided that, at least, one of the following conditions is met**:
  - the profit obtained or damage caused exceed €250,000;
  - the funds used exceed €2 million; or
  - market integrity is seriously impaired;
- **entering into transactions or placing orders to trade that give false or misleading signals as to the supply of, demand for, or price of, a financial instrument or a related spot commodity contract or a benchmark, or securing the price of one or several financial instruments or a related spot commodity contract at an abnormal or artificial level, provided that, at least, one of the following conditions is met**:
  - the offender has obtained a profit exceeding €250,000 or has caused damage exceeding that amount;
  - the funds used exceed €2 million; or
  - market integrity is seriously impaired.

This offence is punishable with:

- **imprisonment of six months to six years**;
- **a fine between €1,440 and €720,000 or of up to three times the profit obtained or the loss avoided, where this is a higher figure**; and
- **a special disqualification (debarment) from trading on financial markets for two to five years**.
Insider trading

Article 285 of the Criminal Code punishes the person who, possessing inside information, engages in insider trading or recommends or induces another person to engage in insider trading, either by acquiring or disposing of financial instruments to which that information relates or by cancelling or amending an order concerning such financial instruments, provided that, at least, one of the following conditions is met:

- the offender has obtained a profit exceeding €500,000 or has caused damage exceeding that amount;
- the value of the financial instruments involved exceeds €2 million; or
- market integrity is seriously impaired.

This provision applies to any person who possesses inside information as a result of:

- being a member of the administrative, management or supervisory bodies of the issuer or emission allowance market participant;
- having a holding in the capital of the issuer or emission allowance market participant;
- having access to the information through the exercise of an employment, profession or duties; or
- being involved in criminal activities.

It also applies to any person who has obtained inside information under other circumstances, where that person knows that it is inside information; however, in such a case, applicable penalties will be less serious.

This offence is punishable with:

- imprisonment of six months to six years;
- a fine between €1,440 and €720,000 or of up to three times the profit obtained or the loss avoided, where this is a higher figure; and
- special disqualification (debarment) from markets and securities-related offices or activities from two to five years.

The penalties imposed will be in the upper half of the range if the offender regularly trades with inside information, or the profit obtained, the loss avoided or the damage caused is especially significant.

Unlawful disclosure of inside information

Article 285 bis of the Criminal Code punishes unlawful disclosure of inside information, which arises when a person possesses inside information and discloses that information to any other person, endangering market integrity or investors’ confidence, except where the disclosure is made in the normal exercise of an employment, profession or duties, including where the disclosure qualifies as a market sounding made in compliance with EU regulations.

This offence is punishable with:

- imprisonment of six months to four years;
- a fine between €720 and €288,000; and
- special disqualification (debarment) from markets and securities-related offices or activities from one to three years.
Incitement and conspiracy

Article 285 quater of the Criminal Code punishes the incitement and conspiracy to commit the above-mentioned criminal offences with less serious penalties than those set out in Articles 284, 285 and 285 bis for such offences.

Finally, according to Articles 31 bis and 288 of the Criminal Code, a legal person may be held criminally responsible for any of these offences, together with guilty natural persons, if the crime was committed by its directors, representatives, agents or employees to the benefit of the entity. In these cases, the legal person will face mandatory fines ranging from one to five times the profit obtained or between €5,400 and €9 million.

In addition, the judge may impose one or more of the following penalties on the legal person:

- winding up of the company;
- suspension of activities (for up to five years);
- closure of premises (for up to five years);
- business ban (for up to 15 years);
- disqualification (debarment) from entering into public contracts, applying for state subsidies and tax or social security benefits (for up to 15 years); and
- judicial management of the company.

A 2015 amendment to the Criminal Code provides for an affirmative defence of compliance (set out in Chapter 2 of Section 31 bis of the Criminal Code) that allows legal entities to be exonerated if they prove in court that an effective compliance programme (or model) to detect and prevent crimes, or to reduce the risk of them being committed, was implemented before the offence took place.

IV CROSS-BORDER ISSUES

Under Regulation (EU) No. 1215/2012 (Brussels I bis) Spanish courts have jurisdiction in civil and commercial matters when the contractual parties agreed to submit their disputes to Spanish courts29 or when the respondent, irrespective of nationality, is domiciled in Spain.30

A defendant domiciled in another EU Member State may be sued in Spain in the following cases:

- when the contract in which the claim is based was performed in Spain;31
- in tortious matters when the harmful event occurred (or, in some cases, had effects) in Spain;32
- when civil liability stems from criminal proceedings held in Spain;33 and
- under certain circumstances where there is more than one respondent and one is domiciled in Spain.34

29 Article 25 Brussels I bis.
30 Article 4 Brussels I bis.
31 Article 7.1 Brussels I bis.
32 Article 7.2 Brussels I bis.
33 Article 7.3 Brussels I bis.
34 Article 8.1 Brussels I bis.
There are two main instances relevant to securities litigation in which defendants not domiciled in an EU Member State may be sued before Spanish courts when the dispute is connected to the operations of a branch, agency or other establishment situated in Spain;35 and when disputes arise out of contracts with consumers that are domiciled in Spain36 provided that the other party pursues commercial or professional activities in Spain.37

If EU law is not applicable in accordance with the aforementioned rules, a foreign person can be subject to Spanish jurisdiction when so provided by an international or bilateral treaty signed between Spain and the state in which the defendant is domiciled. In these cases, the scope of Spanish jurisdiction will be determined by the treaty. In the absence of an international instrument alone, the Judiciary Act will apply, which establishes a very similar scheme to that of EU law in this matter.

To challenge jurisdiction, the respondent may file a motion to dismiss before the court38 within 10 days of service of process. Once the motion is filed, the proceedings will be suspended until the court issues a decision. The doctrine of forum non conveniens is not recognised in Spain. When Spanish courts have jurisdiction according to the law, they are bound to exercise it on the basis that a different solution would compromise legal certainty.

In criminal matters, Article 23.1 of the Judiciary Act states that Spanish courts have jurisdiction to try any offence committed in Spanish territory.

V YEAR IN REVIEW

The financial crisis of 2008 triggered an outbreak of securities litigation and arbitration in Spain that is still ongoing. Thousands of claims have since been filed before Spanish courts and the Supreme Court has had the opportunity to issue important rulings in the field, sometimes revisiting old civil categories of renewed importance.

The courts have stressed the importance of assessing error in consent on a case-by-case basis, carefully analysing the particular circumstances in which the plaintiff entered into a contract involving securities. However, the courts have also considered that the mere infringement of information duties cannot automatically imply the annulment of a contract with a consumer.39

Several class actions have recently been filed in connection with financial instruments. Nevertheless, the fact that Spanish civil procedure is mainly designed for individual claimants has led to most of them being dismissed on procedural grounds.

The Bankia case decided by the Supreme Court in February 2016, regarding the Bankia IPO in 2011, has had a significant impact in securities litigation. In this judgment, dealing with small investors, the Supreme Court considered that the alleged financial inaccuracies of the IPO’s prospectus had led to an error in the investors’ consent because it was directly linked to the misleading financial information provided. It also ruled that civil courts were allowed to resolve cases regarding the Bankia IPO, even though there were ongoing correlated criminal proceedings. On 24 February 2017, the Supreme Court handed down an important

35 Article 7.5 Brussels I bis.
36 The concept of ‘consumer’ is an autonomous EU law concept that has been defined as the person entering into a contract for a purpose that is outside the individual’s trade or profession (Article 17.1 Brussels I bis).
37 Article 17.1(c) Brussels I bis.
38 Articles 63–65 CPA.
39 Judgment of the Spanish Supreme Court (First Chamber) of 15 December 2014 and 21 February 2017.
decision on floor clauses (i.e., those setting a lower limit on interest). The decision is important for securities litigation since it rejects the application of the *res iudicata* effects of judgments in class actions to individual actions with potentially overlapping scope.

Another important judgment was issued on 15 November 2017. In this ruling, which followed the criteria set by the European Court of Justice on the matter (C-186/16), the Supreme Court concluded, contrary to its former understanding, that multi-currency mortgages are not a financial instrument, and, therefore, the LMV does not apply. This approach was confirmed by the Supreme Court in its judgment of 31 October 2018.

The statute of limitations, a key procedural defence in securities litigation, has also been debated by the Supreme Court in its judgments of 31 January and 19 February 2018. Notably, while the Court confirmed its prior interpretation in the first judgment, it seemed to change its view in the second. Given the disparate factual background between the cases, whether the Court’s interpretation has changed is unclear.

Another aspect worth mentioning is that, within the existing debate regarding the nature of virtual currencies and their possible consideration as securities, the CNMV unofficially declared that virtual currencies should not be *per se* considered as such. This position was indirectly confirmed in March 2019, in the context of the first initial coin offering (ICO) made in Spain under the utility token modality. In this case, the CNMV stated that, in view of the described nature, management and use of such tokens, this currency could not be considered as a security.\(^{40}\) Before that, on 20 September 2018, the CNMV had published on its website some of the initial criteria it was considering in connection with ICOs.\(^{41}\) Nevertheless, this guide does not expressly regard this issue.

Securities-related arbitration proceedings have continued to be brought by private investors against financial entities.

The criminal trial on Bankia’s 2011 IPO started in November 2018 against the bank, its former directors and the auditors on charges of investment fraud, misappropriation and accounting fraud. It will probably end by mid 2019 and will result in the first judgment in which a Spanish court rules on the criminal offence of investment fraud.

Criminal investigation on Banco Popular’s management before its resolution in June 2017 by EU’s Single Resolution Mechanism is still going on against the bank’s former directors and auditors. The main new feature this year is that Banco Santander (which acquired Banco Popular) has been called to the proceedings as suspect following the application by the investigative judge of a Criminal Code provision that provides for the transfer of corporate criminal liability in merger and acquisition cases. At the same time, several individual civil cases were filed against Banco Santander (which acquired Banco Popular).

VI OUTLOOK AND CONCLUSIONS

In recent years, legislation and case law have evolved to ensure that operators in securities markets conduct themselves with higher standards of diligence and that consumers are

\(^{40}\) The CNMV also pointed out that this assessment should be made on a case-by-case basis.

afforded enhanced protection. In this respect, EU legislation has contributed to harmonising legal systems across Europe by imposing stricter duties of information, transparency and assessment of the adequacy of financial products for potential investors.

The Bankia case continues to have an important impact on securities litigation, stressing the importance of the analysis of the investor’s profile when the allegations concern the contravention of information obligations or the absence of, or faults in, the plaintiff’s consent. The Supreme Court’s revisited interpretation of several legal institutions in this and in some other recent judgments is a source of debate.

The developments in the Bankia and Banco Popular cases show a shift on the potential criminal liability of financial markets’ supervisors and gatekeepers (e.g., auditors). From the initial prosecution of top government officers of those supervisory bodies along with the auditors, cases have evolved to criminal charges raised exclusively against the gatekeepers. The trend started in the Bankia and Banco Popular cases seems to confirm the path of prosecution.
I OVERVIEW

Sources of law

The Swedish legal framework governing securities has undergone major changes since the beginning of the 21st 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;2 and
c. Regulation (EU) No. 596/2014 (the Market Abuse Regulation (MAR)).

EU directives are implemented in Sweden via acts passed by the 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).3

There are also several statutes potentially relevant in the context of securities litigation that do not deal specifically with securities.

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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.
These include, *inter alia*:

- the Companies Act (2005:551);
- the Code of Judicial Procedure (1942:740); and
- 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 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 essentially is an 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.

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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.
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.

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

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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.
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.  

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 court. 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 definitely 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).

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12 Chapter 2, Section 4 of the Market Abuse Act.  
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.
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.

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 from 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

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 Tidskrift No. 12017/18 p. 233 et seq. As noted above, the board, the CEO and the auditor share a joint and several liability for breaches of the applicable annual accounts legislation.
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 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

General

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;

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 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.
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 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.

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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).
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 exemptions to the rule relating to, for example, certain mandatory rules on confidentiality.
30 Chapter 42, Section 6 of the CJP.
31 Ibid.
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 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, 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 it is 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 basically 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;

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32 Chapter 43, Section 7 of the CJP.
33 Chapter 18, Section 1 of the CJP.
34 Sw. Advokat.
35 Section 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.
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; 

e the group is appropriately defined, taking into consideration its size, scope and other factors;38 and 

f 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.

Claims for damages resulting from improper securities activities fulfil the first criteria 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 iudicata 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 aggravated 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

38 There are no limits, neither maximum nor minimum, as regards the number of possible class members.
the extent of the loss, and the amount of the claimed damages is minor. 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:

- 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.

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:

- request information from market participants and disclosure of relevant documents;
- summon and question any person who might possess relevant information;
- carry out on-site inspections;
- suspend trading of the financial instrument concerned;
- require the temporary cessation of any practice that the SFSA considers contrary to the MAR;
- refer matters for criminal investigation;
- impose a temporary prohibition on the exercise of professional activity; and
- 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.

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.

39 Chapter 35, Section 5 of the CJP.
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.
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. 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.

**Criminal actions**

According to 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...

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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.
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.
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.45

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.

IV CROSS-BORDER ISSUES

Jurisdictional issues

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.46 A respondent not domiciled in a Member State is, in general, subject to national rules of jurisdiction.47 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).48 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, contracts49 (Article 7.1.a), tort50 (Article 7.2) and consumer contracts (Articles 17–18).51 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.52

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. It later turned out that the instruments had lost their value. As an investor having suffered

45 Chapter 4, Section 1, Paragraph 2 of the Market Abuse Act.
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.
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.

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 the courts at the place of 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.

**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.

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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 require a contract to have been concluded. Identifying a contractual obligation is nevertheless essential if that provision is to apply, for jurisdiction under that provision is established on the basis of the place of performance of the contractual obligation in question. Thus, the application of the rule of special jurisdiction provided for matters relating to a contract in Article 7.1.a presupposes the establishment of a legal obligation freely consented to by one person towards another and on which the claimant’s action is based. The court however concluded that such a legal obligation freely consented to by Barclays Bank with respect to Mr Kolassa was lacking (Paragraph 40).

54 It should be noted that these rules determine the internal jurisdiction but they are considered applicable ex analogia in international disputes.
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. 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:

a Section 3 allows jurisdiction for the district court in the place where the respondent’s property is located. 56

b In matters relating to contracts, Section 4 allows jurisdiction for the district court in the place where the contract was entered into. 57

c 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.

d 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.

e 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.

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. 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

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.
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 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).
residence (Article 4.2). 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).

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 damini), 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 on 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.

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.

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).


63 Article 4.1. Articles 5–12 provide special rules for particular types of torts (none of which are of relevance in the field of securities litigation).

64 See Rome I and Rome II Regulations, recital 7.

65 Chapter 2, Section 1, Paragraph 1 of the Swedish Penal Code. If, under Swedish law, the punishment for the act cannot be more severe than a fine, a further requirement is that act is subject to criminal responsibility both under the law of the place where it was committed and under Swedish law (Paragraph 2).
There are also a few other rules that allow 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).66

V YEAR IN REVIEW

The Swedish courts and authorities are in the process of establishing a new practice following the new laws and amendments MiFID, MiFIR and MAR gave rise to and that came into effect during 2017. Only minor changes have been made in the relevant regulations during 2018. By way of example, the Securities Market Act now requires stock exchanges to keep a register of certain employees’ securities.67 There have also been a few amendments to the Act Complementing the EU’s Market Abuse Regulation, which came into effect on 1 January 2019. The legislation now sets out that if an individual has violated MAR, he or she may be forbidden from acting as a CEO or as a member of the board of directors for a certain period of time.68

Judgment has been rendered in a few high-profile cases during the year. In November 2018, the Svea Court of Appeal decided on a case regarding two former members of the board of directors in a tech company.69 The accused were found guilty of insider trading by way of using insider information about the company when trading with financial instruments. However, the Svea Court of Appeal alleviated the punishment for the two compared with the judgment in the district court. This was partly due to the fact that the careers of the accused would take damage following a conviction. A public prosecution has also recently been brought against the former CEO of a well-known game company. The defendant is accused of using secret information about the company’s result prior to the public announcement of the information. A verdict is expected later this year.

VI OUTLOOK AND CONCLUSIONS

In our opinion, investor protection has, 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.70 The proposal has not yet led to any law reforms.

In June 2018, the SFSA published a report regarding market manipulation and insider trading and its experiences following the new laws and regulations.71 In its report, the SFSA

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66 Special rules of jurisdiction are set forth in, for example, Chapter 2, Section 3 of the Swedish Penal Code. There are also special rules pertaining to international crimes (Section 6). Also, Section 7 explicitly gives effect to any limitations resulting from generally recognised fundamental principles of public international law or from special provisions in agreements with foreign powers.

67 Chapter 1, Section 15 of the Securities Market Act.

68 Chapter 5, Section 4 of the Act Complementing the EU’s Market Abuse Regulation.

69 Svea Court of Appeal, Case No. B 7383-17.

70 Ds 2013:16.

notes that the increase in reports of suspected behaviour is likely due to an increased awareness of suspected violations among the public. The SFSA also concludes that the implementation of MAR has enabled the SFSA to intervene and prevent suspected market manipulation in additional ways. However, it remains to be seen if the implementation of MAR is enough for the SFSA and the SNECA to handle the increase of suspected market manipulation, or if additional legislation is necessary.
Chapter 20

SWITZERLAND

Jodok Wicki, Kaspar Landolt and Dominique Gemperli

I OVERVIEW

i Sources of law

In Switzerland, the law of securities is composed of a multitude of statutes, pertaining to private, public and criminal law.

In the context of private law, relevant provisions are found first of all in the Swiss Code of Obligations (CO). Article 41 CO is the basic torts provision. In contract law, the provisions on agency in Article 394 et seq. CO, including Article 11 of the Federal Act on Stock Exchanges and Securities Trading (SESTA) regulating securities traders’ behaviour stand out. Finally, the provisions with regard to companies limited by shares in Article 620 et seq. CO, concerning negotiable securities in Article 965 et seq. CO, and on debt securities issued as bonds in Article 1156 et seq. CO are relevant.

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, securities are 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). On 15 June 2018, the Swiss Parliament adopted the Financial Services Act (FinSA) and the Financial Institutions Act (FinIA). The two new acts will likely enter into force on 1 January 2020. As the implementing ordinances are not yet finalised, they are discussed in a cursory manner in Section VI.

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.

1 Jodok Wicki is the managing partner, Kaspar Landolt is a partner and Dominique Gemperli is a counsel at CMS von Erlach Ltd. Susanna Gut, a former associate at CMS von Erlach Poncet Ltd, contributed to the fourth edition of this chapter.

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ii Regulatory authorities

FINMA is given certain limited general powers and tools to enforce the provisions of the FMIA\(^2\) and additional specific instruments, such as, for example, to proceed against the failure to disclose shareholdings, insider trading and market manipulation.\(^3\) It should be noted, however, that there is presently no Swiss authority that reviews issue prospectuses (as opposed to listing prospectuses, which are reviewed by the exchange where listing is sought, such as, in particular, the SIX Swiss Exchange). Under the FinSA a prospectus will have to pass scrutiny by a specially admitted auditor.\(^4\)

While FINMA is entitled to take administrative measures under the FMIA, the Federal Department of Finance is generally responsible for prosecuting violations of the criminal provisions of the financial market acts, unless provided otherwise.\(^5\) The Attorney General of Switzerland is entrusted with the prosecution of market manipulation and insider trading.\(^6\)

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 such little case law, including:

\(a\) the cost of litigation is high, with a prohibition of contingency fees and a loser-pays rule;

\(b\) there are no instruments for mass claims; and

\(c\) the burden of proof lies often on the investor, leading to a high litigation risk and a rather litigation-adverse attitude.

On 2 March 2018, the Swiss Federal Council published a draft amendment of the CPC that should address these shortcomings.

As there is no public supervision of securities offerings, the public enforcement of securities claims mainly relates to matters such as insider trading,\(^7\) market disruption,\(^8\) reporting duties,\(^9\) the duty to make an offer,\(^10\) and wrong or missing information in a prospectus.\(^11\)

II PRIVATE ENFORCEMENT

i Forms of action

Prospectus liability

The basic provision for actions regarding prospectus liability is set out in Article 752 CO, which reads as follows:
Where information that is inaccurate, misleading or in breach of statutory requirements is given in issue prospectuses or similar statements disseminated when the company is established or on the issue of shares, bonds or other securities, any person involved whether wilfully or through negligence is liable to the acquirers of such securities for the resultant losses.

Scope of application
Article 752 CO may apply when two prerequisites are fulfilled. First, a company must issue securities, that is, through creating or increasing equity capital or by raising debt. All categories of securities may be relevant, as long as they are issued to an extended number of investors.¹² The provision only applies to a securities issue on the primary market, namely initial public offerings and fixed price underwritings. It does not, however, apply to secondary placements where an investor sells his or her securities to the public.¹³

Second, an issue prospectus or a similar statement has been published no matter of whether there is a statutory duty or whether it was published voluntarily. Prospectus liability also applies to omissions, when there is a failure in complying with the legal obligation of publishing an issue prospectus.¹⁴

The issue prospectus is a written document drafted by the issuer to inform potential investors about the intended transaction (sale, subscribing, purchase) and to invite them to participate in the transaction.¹⁵ The duty to publish an issue prospectus and its required content are defined in Article 652a CO (concerning shares) and Article 1156, Paragraph 1 CO (concerning bonds). ‘Similar statements’ refers to any information provided by the issuer to potential investors, as far as the information relates to the issue and serves as a means of information, advertisement or guarantee.¹⁶

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.¹⁷ In the frame of prospectus liability, damages usually occur only after the public learns of the inadequacy of the information provided in the prospectus.¹⁸ 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.¹⁹

¹⁴ Wattet, (footnote 11), Article 752 No. 5.
¹⁵ Wattet, (footnote 11), Article 752 No. 5.
¹⁶ Wattet, (footnote 11), Article 752 No. 14.
¹⁹ Wattet, (footnote 11), Article 752 Nos. 22, 24.
Violation of duty

Liability under Article 752 CO applies 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). Apart from corporate law, 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 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.

Another basis for a damages claim may be breach of trust. Requirements are a special relationship 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 investor must prove reliance on inadequate information provided by the prospectus, and that he or she would not have purchased the securities, or

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20 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 scheme Articles 75–77 CISA determine the prospectus duties.
21 Watter, (footnote 11), Article 752 No. 18 et seq.
22 Dieter Gericke/Stefan Wätter, (footnote 39), Article 754 No. 24.
23 Article 154 FMIA.
24 Article 155 FMIA.
25 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.
27 DFT 134 III 390, 395.
28 DFT 130 III 345, Cons. 2.1 et seq.
29 DFT 132 III 718, Cons. 2.1.
30 Wätter, (footnote 11), Article 752 No. 26.
would have done so at a lower price with adequate information. Since it is 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.

In cases where the 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.

Fault
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.

With regard to prospectus liability, the Swiss Supreme Court held that it is not negligent if the involved persons rely on experts (such as lawyers) and that only the underwriting bank may have a (limited) duty to verify the information provided by the issuer.

Standing to sue and to be sued
In accordance with Article 752 CO, anyone who purchases securities 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 securities. The body of creditors and the company itself are not entitled to sue.

Any person involved in drafting or disseminating the prospectus or similar statement can be sued. This may include lawyers, advisers, rating agencies, consortium banks and financial institutions. Finally, the issuer itself may also be a defendant.

Burden of proof
The Swiss Supreme Court qualified the legal nature of prospectus liability as a liability in tort and denied contractual liability. This qualification imposes on the investor carrying the burden of proof for all requirements for liability under Article 752 CO, including loss, violation of duty, causation and the issuer’s fault.

Statute of limitations
The statute of limitations is set out in Article 760 CO. Claims for damages are time-barred five years after the date on which the acquirer learned of the loss and the person liable for it (relative time limit). In any event, the claim becomes time-barred 10 years after the date of

31 DFT 132 III 718, Cons. 2.1. and Cons. 3.2.
32 DFT 132 III 718, Cons. 3.2.1.
33 BGE 123 III 110, Cons. 3(a).
34 DFT 129 III 71, 75 et seq.
35 DFT 131 III 306, Cons. 2.1.
36 DFT 113 II 283, 289 et seq.
37 Watter, (footnote 11), Article 752 Nos. 9, 9a.
38 Watter, (footnote 11), Article 752 No. 10.
39 Watter, (footnote 11), Article 752 No. 11.
40 DFT 129 III 71 Cons. 2.5.
the act causing the loss (absolute time limit). In the event the claim is derived 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 securities 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 advisors and securities dealers 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(2) in connection with Article 97(1) CO:

- violation 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.

The stock exchange law specifies in addition the obligations under the simple agency agreement in the field of securities transactions. Article 11(1)(a) SESTA stipulates a duty

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41 In the frame of the portfolio management, the asset manager has the obligation to make the investment decisions and adopt the investment strategy. Whereas an investment advisor 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.


43 These obligations are based on Article 398(2) CO. Christoph Gutzwiller, Schadensstiftung und Schadensberechnung bei pflichtwidriger Vermögensverwaltung und Anlageberatung, SJZ 2005, 357, 360.


45 Christoph Gutzwiller, Schadensstiftung und Schadensberechnung bei pflichtwidriger Vermögensverwaltung und Anlageberatung, SJZ 2005, 357, 358.
to provide information on the risks that are linked to certain types of transactions. This provision qualifies both as public and as private law and a violation may be claimed by the public authorities and the contracting parties.46

One of the common subjects of dispute is whether the violation of duty was ratified, for example, if the investor never objected against the custody account statements that were duly delivered.47

**Causation**

Causation under the simple agency agreement requires both actual cause and legal proximate cause.48 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.49

**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.50

**Standing to sue and to be sued**

Any investor who is party of the 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 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 years51 after the loss occurred.52

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47 Christoph Gutzwiller, Schadensstiftung und Schadensberechnung bei pflichtwidriger Vermögensverwaltung und Anlageberatung, SJZ 2005, 357, 361.
49 DFT 120 II 250.
50 Based on Article 100(1) and Article 100(2) CO, liability may not be excluded for unlawful intend or gross negligence in advance.
51 Article 127 CO.
52 DFT 130 III 597.
ii Procedure

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. In a canton with a commercial court, the commercial court may be competent.

In most cases, court proceedings are preceded by mandatory conciliation proceedings, unless a commercial court has jurisdiction. In addition, the claimant may unilaterally waive conciliation proceedings if the other party resides abroad. 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.

Decisions of the first instance may be appealed to the cantonal appellate courts, followed by appeal to the Swiss Federal Court whose review, however, is basically limited to legal issues.

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 or the courts may join several proceedings in one proceeding. A group action according to Article 89 CPC is directed at protection of personality rights and enables the group only to request prohibition of a violation, or 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 for attorney’s fees. Both are determined based on cantonal tariffs that reflect the amount in dispute and the complexity. Contingency fee arrangements are prohibited.

53 Article 40 CPC.
54 There are commercial courts in the cantons of Aargau, Berne, St Gallen, Zurich.
55 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 752 CO), the decision is subject to an appeal with the Swiss Federal Court (if the amount in dispute is of at least CHF 30,000), 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.
56 Article 197 et seq. CPC.
57 Article 198 lit. f and 199 CPC.
58 Article 8 CPC.
59 Article 308 et seq. CPC.
60 Article 72 SCS.
61 Article 95 et seq. SCS.
62 Article 71 CPC.
63 Article 125 lit. c CPC.
64 Article 106 CPC.
65 Article 96 CPC.
iii Settlements

Settlements can be concluded anytime, out of court or in court. In-court settlements qualify as surrogate court decisions\(^\text{66}\) that are enforceable and have \textit{res judicata} effect.\(^\text{67}\)

Claims in the context of corporate liability\(^\text{68}\) 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 only between some of the involved persons but not all would have \textit{erga omnes} effect, meaning that it has effect beyond the parties of 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.\(^\text{69}\)

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.

\textit{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:

\begin{itemize}
  \item[a] exploits it to acquire or dispose of securities listed in Switzerland or to use financial instruments derived from such securities;
  \item[b] discloses it to another; or
  \item[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.
\end{itemize}

A corresponding, but slightly more restrictive, criminal provision is set forth in Article 154 FMIA.

\(^{66}\) Article 208(2) and Article 241(2) PILA.


\(^{68}\) Namely, the prospectus liability or the liability for administration, business management and liquidation, the auditors’ liability (Article 752 et seq. CO).

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 or 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.\(^{70}\)

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, 33\(\frac{1}{3}\), 50 or 66\(\frac{2}{3}\) 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.\(^{71}\)

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 33\(\frac{1}{3}\) per cent of the voting rights of a target company, whether exercisable or not, must make an offer to acquire all listed equity securities of the company. Target companies may raise this threshold to 49 per cent of voting rights in their articles of incorporation.\(^{72}\)

Non-licensed banking activity

Professional acceptance of public funds is reserved to banks licensed by FINMA,\(^{73}\) 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 criminal provisions of the FMIA are violated,\(^{74}\) save that the Attorney General of Switzerland is responsible to prosecute certain offences, such as the criminal offence of insider trading and market manipulation.\(^{75}\) The Federal Act on

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\(^{70}\) Article 155 FMIA.

\(^{71}\) Article 120 FMIA.

\(^{72}\) Article 135 FMIA.

\(^{73}\) Article 1, Paragraph 2 Act on Banks and Savings Banks.

\(^{74}\) Article 50, Paragraph 1 FINMASA.

\(^{75}\) Article 156, Paragraph 1 FMIA.
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.\textsuperscript{76}

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.\textsuperscript{77}

\section*{iii Settlements}

\textbf{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.

\textbf{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.\textsuperscript{78} These provisions apply, by reference, also to the ACL.

\section*{iv Sentencing and liability}

\textbf{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.\textsuperscript{79}

\begin{footnotesize}
\begin{itemize}
\item[76] Article 50, Paragraph 1 FINMASA and Article 1 of the SCP.
\item[77] Article 50, Paragraph 2 FINMASA.
\item[78] Article 53 of the Criminal Act.
\item[79] Article 145 FMIA.
\end{itemize}
\end{footnotesize}
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.\(^8^0\)

**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.\(^8^1\) If the profit exceeds 1 million Swiss francs, imprisonment may be up to five years.

Penalties 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.\(^8^2\)

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 up to three years.\(^8^3\)

**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 have to 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 has to 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 like the taking of evidence or the service of judicial documents may also be subject to international conventions.\(^8^4\)

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,\(^8^5\) or in a special jurisdiction depending on the legal nature of the claim. If the claim concerns contractual matters,\(^8^6\) there is a

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80 Article 144 FMIA.
81 Article 154 et seq. FMIA.
82 Article 151 et seq. FMIA.
83 Article 148 Paragraph 1 lit. f CISA.
84 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.
85 Article 2(1) LC.
86 Article 5(1)(b) LC.
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.87 Finally, there is a mandatory jurisdiction in favour of consumers.88

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 either to sue at the place of the defendant’s residence89 or at a special jurisdiction at the place of performance90 or at the place where the harmful action was executed or the injury resulted.91 Like the LC, the PILA also provides for mandatory consumer jurisdiction.92 Contrary to the LC, the PILA provides for additional special jurisdictions for corporate matters, such as prospectus liability, or 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,93 or at the place of issue of the securities.94

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 the performance is rendered.95 If the investor is considered a consumer, the law at his or her usual place of residence will apply.96 If the action is based on tort and the parties have a common habitual residence, the law of that place applies.97 Otherwise, the law of the state where the harmful action was taken, or where the harmful event occurred, may apply.98

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.99

### ii Public enforcement

Cross-border issues may arise if a foreign entity violates a financial market act, such as the FMIA or the CISA.

The FMIA is applicable, among others, to securities listed in Switzerland, irrespective of the domicile of the parties involved. The CISA is applicable, among others, to Swiss collective investment schemes and to foreign collective investment schemes that are distributed in Switzerland.

In order to enforce the financial market acts against a foreign entity, FINMA may ask foreign financial market supervisory authorities for assistance100 or may itself carry out audits of supervised persons and entities abroad or have such audits carried out by audit agents.101

87 Article 5(3) LC.
88 Article 15 LC.
89 Article 2 PILA.
90 Article 113 PILA.
91 Article 129 PILA.
92 Article 114 PILA.
93 Article 151(1) and (2) PILA.
94 Article 151(3) PILA. The jurisdiction at the place of issue of securities may not be excluded by a forum clause.
95 Article 116 PILA.
96 Article 120 PILA.
97 Article 133(1) PILA.
98 Article 133(2) PILA.
99 Article 156 PILA and Article 154 PILA.
100 Article 42 et seq. FINMASA.
101 Article 42, Paragraph 1 FINMASA.
V YEAR IN REVIEW

By a judgment of 17 December 2018, 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 the past year was whether initial coin offerings (ICOs) qualify as securities and whether under which conditions ICOs should be subject to securities regulations. No related litigation has entailed so far, however.

VI OUTLOOK AND CONCLUSIONS

The current financial market acts have significant shortcomings in the area of code of conduct and product regulations. The prospectus duty for financial products is dispersed throughout various laws and regulations and lacks consistency. Owing to the enormous size of most of the prospectuses, an assessment of the product is difficult, and (other than in the area of collective investment schemes) concise product documentation that is easy to understand is hardly available. The options for clients to assert their rights are severely restricted and entail high-cost risks. Different degrees of regulation and supervision apply to the various financial service providers for no apparent reason. Accordingly, the current laws lack sufficient client protection and equal competitive conditions.

To solve these shortcomings, the bills of two new laws, namely the FinSA and the FinIA, were passed by Parliament on 15 June 2018. The FinSA and the FinIA will likely enter into force on 1 January 2020 and shall create uniform competitive conditions for financial intermediaries and improve client protection.

The FinSA is, to a large extent, based on EU law (MiFID, Prospectus Directive, PRIPs project) with adjustments made to reflect specific Swiss circumstances. The FinSA encompasses cross-sector rules for offering financial services and distributing financial instruments and provides clients with the necessary tools to assert their claims. The three main client segments are private clients, professional clients and institutional clients. The FinSA introduces a uniform prospectus duty for securities that are publicly offered or traded on a trading platform. The law provides for various exemptions, depending on the offer itself (e.g., its addressees, the number of addressees, value) and the type of securities offered. Among others, offers addressed to professional clients only would not require a prospectus. The FinSA also sets forth a prospectus duty for open and closed collective investment schemes. In contrast to the existing legislation (but in line with EU law), any prospectus needs to be submitted to an independent audit body for review and approval before its

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103 Aufsichtsmitteilung 04/2017 of 29 September 2017 by FINMA.
104 Article 37 draft FinSA.
105 Article 38 et seq. draft FinSA.
106 Articles 50 and 51 draft FinSA.
107 Prüfstelle.
distribution.\textsuperscript{108} In addition to a prospectus, a key information document has to be supplied for most financial instruments offered to private clients.\textsuperscript{109} It shall enable private clients to make informed investment decisions and to truly compare various financial instruments in a simple and comprehensible way.

The FinIA essentially harmonises the authorisation rules for financial service providers. In contrast to the existing laws, it introduces a prudential supervision of managers of individual client assets, managers of the assets of occupational benefits schemes and trustees.

The Swiss Federal Council published drafts of the ordinances on FinSA and FinIA on 24 October 2018 for public comments. The final versions of the ordinances are yet to be published.

Strengthening enforcement is a hot topic in Switzerland. On 2 March 2018, the Federal Council published a draft amendment of the CPC for public comment, intending to reduce legal costs for claimants, to facilitate group actions by an association to claims for damages (opt-in) and to provide for a new procedure for group settlements (opt-out). It is too early to speculate whether such amendments will make it into law.

\textsuperscript{108} Article 53 FinSA.

\textsuperscript{109} Article 60 et seq. draft FinSA.
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 and the Taipei Exchange, 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

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1 Edward Liu is a partner and Eunice Chen is an associate at Chen & Lin Attorneys-at-Law.
2 TWSE.
3 TPEx.
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 part 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 not less 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 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 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; 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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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 prosecutors office decided to render a deferred prosecution considering there was no damage incurred to the company, but this decision was later overruled by the Taiwan High Prosecutors Office.

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 in secrecy, internally 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 with a minimum punishment of imprisonment for 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 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 the 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, a sentence more than three years, 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 to 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 himself 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 set 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 amendments to the Securities Act were adopted on 25 April 2018, 5 December 2018 and 17 April 2019, and include the following:

a Prohibiting the company from impeding, refusing or evading the actions of the independent directors in the performance of their duties and allowing independent directors to request the board of directors to appoint relevant personnel, or at their own discretion to hire professionals, at the company’s expense, to provide assistance for their performance of duties, and any violation will be subject to a fine.
Requiring that a company whose stock is listed for trading on the stock exchange or over-the-counter securities exchange shall additionally disclose relevant information, including the average salary of all the company's employees and any adjustments thereto, in accordance with the regulations prescribed by the competent authority when preparing its annual financial report.

Enhancing the regulatory power, including empowering the authority to issue a corrective order, increasing the maximum penalty amount under Article 178 from NT$2.4 million to NT$4.8 million and subjecting securities firms, securities finance enterprise, securities central depository enterprise, other securities-related services, etc., to fines in the event of any violation of the Securities Act.

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.
Chapter 22

UNITED STATES

William Savitt and Noah B Yavitz

I OVERVIEW

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;

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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 new wave of federal securities legislation continues to reverberate through the American legal system, as the agencies charged with establishing regulations under Dodd-Frank complete their implementation of the statutes and the federal courts interpret their provisions. Moreover, the 2016 election in the United States led to further uncertainty, raising the likelihood – as yet unrealised – that recent legislation and rule-making may be revisited in the coming years. What is certain is that the legislation of the past several decades will continue to alter the scope and character of securities regulation 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 – although the binding power of these administrative proceedings is a hotly litigated issue, as explained further below (see Section V). 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.
iii 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.2

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

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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* 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 a broad expansion of ‘scheme’ liability, as discussed in Section V.ii.

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.

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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.
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 wilful.

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 transaction complained of.8 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,9 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

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. However, some courts have held that false statements or omissions are not materially misleading as long as the market possessed the correct information. 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’. 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’.

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’. This provision of SLUSA was enacted to block plaintiffs from using 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’. 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

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10 Id. 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.
11 United States v. Litvak, 808 F.3d 160, 176 (2d Cir. 2015).
12 See, e.g., In re Convergent Techs Sec Litig, 948 F.2d 507 (9th Cir. 1991).
13 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).
14 Singh v. Cigna Corp, 918 F.3d 57, 63 (2d Cir. 2019). See also id. 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).
16 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).
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). 17

Notably, while SLUSA restricts plaintiffs’ ability to circumvent federal law, the Supreme Court recently held in *Cyan Inc v. Beaver County Employees’ Retirement Fund* 18 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.

**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’. 19 Once a plaintiff satisfies this burden, then 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.

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17 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); *Holts v. JPMorgan 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, *Holts*, 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 15 U.S.C. Section 77k(a).
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’. 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.

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.

In Omnicare, Inc v. Laborers District Council Construction Industry Pension Fund, 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 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 it.

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21 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).
22 Notably, an underwriter typically cannot rely on indemnification to shift its liability to an issuer. See, e.g., Perry v. Duowan 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’).
their public statements. 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.

**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. Unlike Section 11 and Section 12(a)(1), which apply only to securities that must be registered under the Securities Act, Section 12(a)(2) applies to all securities except those specifically exempted.

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. 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.

**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. Under Section 10(b), the SEC is empowered to prohibit ‘the use of a manipulative or deceptive device or contrivance’ in connection with the purchase or sale of any securities 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.

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24 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).


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 fact28 (2) with scienter (3) in connection with the purchase or sale of a security (4) upon which the plaintiff justifiably relied29 and (5) that proximately caused (6) the plaintiff’s economic loss.30 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’.31 But whether a particular buyer or seller relied on an alleged misstatement is 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,32 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’.33 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

28 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 and Ninth Circuits are at odds over whether a company can face liability under Section 10(b) for a failure to disclose ‘known trends and uncertainties’ in compliance with Item 303 of Regulation S-K. Compare In re Nvidia Corp Sec Litig, 768 F.3d 1046 (9th Cir. 2014) (holding that ‘a violation of Item 303 cannot be used to show a violation of Section 10(b) and Rule 10b-5’), 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.

29 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).


33 Id. at 247.
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.34

More recently, in *Halliburton Co v. Erica P John Fund, Inc,*35 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 Circuit has held that defendants must ‘demonstrate a lack of price impact by a preponderance of the evidence’ under *Halliburton,*36 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’.37 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.38

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,*39 the Court unanimously held that ‘an inflated purchase price will not itself constitute or proximately cause the relevant economic loss’.40 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.41

34 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).


36 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).

37 See *IBEW Local 98 Pension Fund v. Best Buy Co,* 818 F.3d 775, 782 (8th Cir. 2016).

38 See id.; *In re Vivendi, SA Sec Litig,* 838 F.3d 223, 259 (2d Cir. 2016) (endorsing a price-maintenance theory); *Glickenhaus & Co v. Household Intern, Inc,* 787 F.3d 408, 419 (7th Cir. 2015) (same); *FindWhat Investor Grp v. FindWhat.com,* 658 F.3d 1282, 1314 (11th Cir. 2011) (same).


40 Id. at 341.

41 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, e.g., *Financial Guaranty Ins Co v. The Putnam Advisory Co,* 783 F.3d 95 (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’
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.*,42 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*,43 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.44

**Insider trading in violation of Section 10**

Since the decision of the SEC in *Cady, Roberts & Co.*,45 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.46 Rather, their duty is to disclose or to abstain from trading until 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

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46 *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).
confidential corporate information to trade in the corporation’s stock for his or her personal benefit. 47 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, 48 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, 49 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. 50 As the Supreme Court recently reaffirmed in United States v. Salman, 51 insider-trading liability extends to circumstances where an insider gifts non-public information to a ‘trading relative or friend’. 52

**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 misleading or necessary to correct any statement in any earlier communication . . . which has become false or misleading’. 53 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. In recent years, this provision has increasingly been invoked by plaintiffs seeking to challenge merger disclosures. 54

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50 Id. at 663.
51 137 S. Ct. 420 (2016).
52 Id. 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), cert. pending (No. 18-972) (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’).
53 17 C.F.R. Section 240.14a-9(a).
54 See, e.g., 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).
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.\(^{55}\) 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.\(^ {56}\)

**Rule 14e-3**

In the context of a tender offer, Rule 14e-3(a) 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.\(^ {57}\) 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

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\(^{55}\) See Dekalb County Pension Fund v. Transocean Ltd, 817 F.3d 393, 408 & n. 90 (2d Cir. 2016).


\(^{57}\) 17 C.F.R. Section 240.14e-3(a).
or reasons why the statement is misleading. In addition, where scienter is an element of the securities claim, plaintiffs must ‘state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind’. 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. 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:

- a. the complexity, expense, and likely duration of the litigation;
- b. the reaction of the class to the settlement;
- c. the stage of the proceedings and the amount of discovery completed;
- d. the risks of establishing liability;
- e. the risks of establishing damages;
- f. the risks of maintaining the class action through trial;
- g. the ability of the defendants to withstand a greater judgment;
- h. the range of reasonableness of the settlement fund in light of the best possible recovery; and
- i. the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

Under Federal Rule of Civil Procedure 23(e)(5), ‘[a]ny class member may object to [a proposed settlement subject to judicial review]’.

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59 Khoja v. Orexigen Therapeutics, Inc, 899 F.3d 988, 999–1018 (9th Cir. 2018).
60 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’.61 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’.62 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.63

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.64 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.65 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.66 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.

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 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.67

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.68

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.69 Indeed, recent decisions from the DC and Second Circuits have sharply 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.70 NPAs are not filed with the courts, and are thus not subject to judicial review.

69 See, e.g., 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”).
70 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).
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.71

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’. 72 In addition, the Court suggested in a footnote that the availability of disgorgement as a remedy in SEC proceedings may be subject to challenge.73 While the full impact of this decision remains to be seen, 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.74 Following Kokesh, the lower courts have struggled to evaluate whether other SEC sanctions are similarly subject to the ‘penalty’ limitations period.75

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.76 The Court

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73 Id. at 1642 n. 3.
75 See, e.g., SEC v. Collyard, 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).
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’. 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’. 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. This decision has been interpreted to apply to the Securities Act as well.

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. 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.

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. Earlier this year, the Tenth Circuit endorsed that position, creating the possibility for a significant expansion in the US government’s power to patrol extraterritorial conduct.

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, following the 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

77 Id. at 273.
78 Id. at 266.
79 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).
80 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.
82 See, e.g., City of Pontiac Policemen’s & Firemen’s Ret Sys v. UBS AG, 752 F.3d 173, 176 (2d Cir. 2014).
83 See SEC v. Scoville, 913 F.3d 1204 (10th Cir. 2019). See also Section V for further discussion of Scoville.
84 677 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).
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 441 new federal class-action securities cases in 2018, marking a 1.6 per cent increase over 2017 and totalling to the most since 2001. 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 stabilised at 210 (as compared with 204 in 2017), while traditional securities class actions also remained relatively unchanged at 192 (as compared with 193 in 2017). The average settlement in 2018 rose to US$69 million from US$25 million the previous year, with median settlement amounts of US$13 million and US$6 million, respectively. On aggregate, securities class-action defendants paid out US$5.3 billion in 2017. Out of this total, class counsel received approximately US$790 million for fees and expenses.

In the realm of public enforcement, the SEC charged 56 people in cases involving insider trading in FY 2018 alone. Overall, the SEC filed 821 enforcement actions, and obtained orders totalling US$3.9 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 United States Congressman who allegedly tipped his son to market-moving information that the Congressman had learned through his service as a corporate director. The SEC also pursued several novel cases against

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85 *Parkcentral Global Hub Ltd v. Porsche Automobile Holdings*, 763 F.3d 198 (2d Cir. 2014). The Second Circuit has applied its ‘predominately foreign’ standard in scrutinising a range of foreign transactions. See, e.g., *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).

86 See *Stoyas v. Toshiba Corp*, 896 F.3d 933 (9th Cir. 2018), cert. pending (No. 18-486). Following the Ninth Circuit’s decision, a petition for certiorari is currently pending before the Supreme Court, raising the possibility of further review.


companies and individuals that failed to disclose corporate data breaches.\textsuperscript{90} And the SEC’s newly inaugurated Cyber Unit continued its enforcement initiative targeting the perpetrators of fraudulent ‘initial coin offerings’ and other cryptocurrency fraud.\textsuperscript{91}

Extending a trend from prior years, the SEC reported explosive growth in its whistle-blower programme in 2018. In its report for the fiscal year, the SEC announced that it had issued total awards of US$168 million to 13 whistle-blowers – a sum greater than the awards issued in all previous years combined.\textsuperscript{92} The lion’s share of this total came from three large awards that exceeded US$20 million, including US$50 million split between two whistle-blowers who helped the SEC collect US$145 million from Merrill Lynch. The SEC also announced robust growth in total whistle-blower tips, which grew 20 per cent year-over-year to 5,200. A portion of this growth was attributed to a Supreme Court decision establishing that whistle-blowers must report to the SEC, not other government agencies or their employers, to receive statutory protections against employer retaliation.\textsuperscript{93} Following the rapid expansion of the whistle-blower program, in June 2018 the SEC proposed 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{94}

The past year also saw several significant 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 that will likely limit 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{95} Second, the Department of Justice announced that it was relaxing its stringent requirements for crediting corporate defendants’ cooperation in investigations. Under the new policy, corporations are eligible for full cooperation credit so long as they identify individuals who are ‘substantially involved’ in misconduct,\textsuperscript{96} whereas before full credit was contingent on the identification of ‘all individuals involved in or responsible for

\textsuperscript{91} See, e.g., SEC v. Sohrab Sharma, Case No. 18-cv-2909 (S.D.N.Y. 2 April 2018); SEC v. Titanium Blockchain Infrastructure Secs Inc, Case No. 18-cv-4315 (C.D. Ca. 22 May 2018); SEC v. Arisebank, Case No. 18-cv-186 (N.D. Tex. 2 February 2018); SEC v. Jon Montroll, Case No. 18-cv-1582 (S.D.N.Y. 21 February 2018). Notably, in November 2018, the DOJ also nabbed its first guilty plea in an ICO fraud case. See Department of Justice, Brooklyn Businessman Pleads Guilty to Defrauding Investors through Two Initial Coin Offerings (15 November 2018), available at https://www.justice.gov/usao-edny/pr/brooklyn-businessman-pleads-guilty-defrauding-investors-through-two-initial-coin.
\textsuperscript{94} See SEC Release No. 34-83557 (18 June 2018).
\textsuperscript{95} Department of Justice, Memorandum for All Criminal Division Personnel: Selection of Monitors in Criminal Division Matters (11 October 2018), available at https://www.justice.gov/opa/speech/file/1100531/download.
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.

ii Significant decisions

China Agritech, Inc v. Resh

This past term, the Supreme Court continued its recent trend of limiting the ability of plaintiffs to prolong the limitations periods applicable to their claims by relying on the pendency of class actions. In China Agritech, the Court held that such ‘class-action tolling’ is limited to subsequent individual actions, and cannot be applied to subsequent class actions. China Agritech comes on the heels of the Court’s recent decision in California Public Employees’ Retirement System v. ANZ Securities, Inc, which held that class actions cannot toll the three-year statute of repose fixed by Congress for claims under the Securities Act. Following China Agritech and ANZ Securities, plaintiffs face renewed urgency to file – or intervene in – putative class actions soon after the revelation of potential securities fraud.

Raymond J Lucia Cos, Inc v. SEC

As discussed above, the SEC often brings enforcement actions as administrative proceedings rather than civil suits in federal court. Critics of this practice have noted that, in the administrative forum, the hearing officer is an SEC administrative law judge and certain procedural protections for defendants are weaker. Resolving a division of authority among the lower courts, in June 2018 the Supreme Court held that SEC ALJs are subject to constitutional restrictions on the appointment of federal ‘officers’. This narrow holding will have limited prospective impact, because prior to the decision the US government had already conceded that SEC ALJs are subject to those restrictions, after which the SEC issued an order that sought to remedy the ALJs’ deficient appointments. Nevertheless, the Court held that individuals who had challenged the constitutionality of their hearings before SEC ALJs prior to this order are entitled to a hearing before a new, properly appointed ALJ. Moreover, beyond its limited holding, the case provides ample fodder for future litigation against the SEC’s ALJ system. Notably, Justice Breyer issued a separate opinion concurring in the judgment that questions the constitutionality of the regulatory provision shielding SEC ALJ’s from removal absent ‘cause’, based on prior Supreme Court decisions that limit the ability of regulators to shield constitutional officers from removal. This potential constitutional infirmity presents a broader threat to the legitimacy of the ALJ system, since its remedy would require a more thorough-going modification of the underlying regulations. The issue has already been taken up in a follow-on challenge by the defendant in Lucia.

102 138 S. Ct. at 2055.
103 See Raymond J. Lucia Cos, Inc v. SEC, Case No. 18-cv-2692 (S.D. Cal.).
**Lorenzo v. SEC**

In March 2019, the Supreme Court opened the door to a significant expansion of ‘scheme liability’ under Rule 10b-5.\(^1\) As discussed above, the Court’s 2011 decision in *Janus Capital* held that only defendants who ‘make’ material misstatements run afoul of the Rule 10b-5(b) prohibition on making an ‘untrue statement of material fact’. In *Lorenzo v. SEC*, the Court was confronted with an SEC action against an investment banker who disseminated false statements that he knew to be false, but which had been drafted by his manager. The SEC conceded that the defendant had not ‘made’ the statements under the rule in *Janus Capital*, but argued that he was nonetheless liable under Rule 10b-5(a), which prohibits ‘any device, scheme or artifice to defraud’, and Rule 10b-5(c), which prohibits ‘any act, practice, or course of business which operates . . . as a fraud or deceit upon any person’. The Supreme Court agreed, reasoning that Rule 10b-5’s other provisions permit a defendant to be held liable for mere ‘use’ of a misstatement even if he did not ‘make’ it. The decision in *Lorenzo* significantly undermines the limitations on Rule 10b-5 liability erected by *Janus Capital* and the decisions that preceded it. While this will likely have a moderated impact on public enforcement – since the SEC can already bring aiding and abetting claims against peripheral wrongdoers – it heralds an expansion of liability for Rule 10b-5 defendants in private litigation.

**SEC v. Scoville**

In January 2019, the Tenth Circuit held that the 2010 Dodd-Frank Act permits extraterritorial prosecutions of securities fraud claims by the SEC and the Department of Justice.\(^2\) At issue in *Scoville* was the impact of Section 929P(b) of the Act, which empowers the government to bring securities fraud claims under the Securities Act or Exchange Act if an alleged violation involves either conduct that occurred in the United States, or actions outside the United States that had a substantial domestic effect. Days before this statutory language was enacted, the Supreme Court’s decision in *Morrison* rejected the ‘conduct and effects’ test enshrined in Section 929P(b), raising questions over how to reconcile the conflicting authorities. The Tenth Circuit held that *Morrison* cannot constrain the authority granted by Congress. While *Scoville* presents a significant endorsement of the government’s expanded authority to prosecute international securities fraud, it remains to be seen whether other federal circuits adopt the Tenth Circuit’s holding and whether it ultimately passes muster with the Supreme Court.

**Varjabedian v. Emulex Corp**

In April 2018, the Ninth Circuit held that scienter is not an element of a claim brought under Section 14(e), a statutory provision that broadly prohibits the making of untrue statements and the commission of fraudulent acts in connection with tender offers.\(^3\) In holding that Section 14(e) only requires proof of negligence, the Ninth Circuit diverged from five other federal circuit courts, which have held that Section 14(e) plaintiffs must prove scienter.\(^4\) In

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\(^1\) 139 S. Ct. 1094.

\(^2\) 913 F.3d 1204 (10th Cir. 2019).

\(^3\) 888 F.3d 399 (9th Cir. 2018).

\(^4\) See *Chris-Craft Industries, Inc v. Piper Aircraft Corp*, 480 F.2d 341 (2d Cir. 1973); *Smallwood v. Pearl Brewing Co*, 489 F.2d 579, 606 (5th Cir. 1974); *Adams v. Standard Knitting Mills, Inc*, 623 F.2d 422 431 (6th Cir. 1980); *In re Digital Island Securities Litig*, 357 F.3d 322 (3rd Cir. 2004); *SEC v. Ginsburg*, 362 F.3d 1292, 1297 (11th Cir. 2002).
late 2018, the Supreme Court granted an appeal of the Ninth Circuit’s decision to review 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.

VI OUTLOOK AND CONCLUSIONS

To date, the Trump administration has not effected any significant change in federal securities law. Republican efforts to enact major legislation – already mothballed in 2016 and 2017 – have now fallen entirely by the wayside as the Democratic Party achieved a majority in the US House of Representatives in the 2018 midterm elections. Notwithstanding this legislative inaction, conservatives have made 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 37 judges on the powerful federal courts of appeals (out of 179 judgeships) and 59 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).

While the SEC also has yet to adopt any significant regulation under the new administration, there are rumblings of change. In December 2018, the SEC invited public comment on whether the time-worn quarterly reporting system for public companies should be replaced with semi-annual reporting.108 If adopted, the change would address concerns that the quarterly reporting system reinforces the negative effects of short-term thinking among market participants. SEC Chairman Jay Clayton has also announced that the Commission’s staff is working to streamline the SEC’s complex patchwork of exemptions for the private sale of securities.109

Meanwhile, the SEC’s Division of Enforcement has re-committed itself to the five ‘core principles’ that it announced in 2018:

- protecting retail investors;
- combating cyber-related threats, including cyber-intrusions, cryptocurrency fraud, and dark web transactions;
- focusing on individual culpability, rather than purely corporate liability;
- increasing reliance on non-monetary rather than monetary sanctions; and
- shifting away from resource-intensive ‘broken windows’ and ‘street sweep’ investigations.

This enforcement programme will likely continue a shift towards actions against individual defendants and efforts to facilitate the return of ill-gotten gains to harmed investors. As noted

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above, the agency’s cyber initiative has continued to pursue enforcement actions against alleged fraudulent activity in connection with ‘initial coin offerings’, continuing the SEC’s close scrutiny of the growing cryptocurrency sector.
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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
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Harry has previously helped UBS in two substantial matters: successfully defending
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Edward Liu has been practising law for more than a decade. He primarily focuses on cross-border dispute resolution. He has handled many cases involving commercial disputes, patent infringement, patent licensing, prosecution against violation of the Trade Secrets Act, securities-related actions, etc. He is highly experienced in management of transnational cases and coordination with clients and counsels from different jurisdictions.

Edward Liu graduated from the National Taiwan University in 2002 and got an LLM degree from New York University School of Law in 2008. He is admitted to the Taipei Bar Association and has passed the New York State Bar Examination.

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Ms Ono was educated at the University of California, Berkeley, and spent a year as a foreign associate in New York, where she assisted Japanese companies in cases such as antitrust and international disputes. She was also a lecturer at the University of Tokyo for two years.

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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 rights litigation, mergers and acquisition/takeover bid litigation and directors’ and officers’ liability.

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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.
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Mr Sekido received an LLM from the University of Chicago Law School and clerked for a year at Fulbright & Jaworski LLP in Houston, Texas. He has been a member of the Tokyo District Court Civil Litigation Practice Committee since 2007.

He has contributed to many publications on dispute resolution, including Guide to International Arbitration for Japanese Companies (1)-(72) (Shojihomu, 2016–2018), ‘Japan’s ruling on no business cessation’ (IFLR, 2014), ‘Decision by the Tokyo High Court on Letters of Credit Issued by a Chinese Bank and Practical Responses’ (Kinyuhomujijo, 2014) and Guide to US Civil Litigation for Japanese Companies (Shojihomu, 2010).

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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.

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Sarah Thomas has over a decade of experience acting for banks and other financial institutions on major regulatory investigations by the PRA, FCA, FRC and United States DOJ. She has represented clients in published regulatory decisions and investigations covering areas such as investment suitability and disclosures, AML systems and controls, institutional bond distribution, LIBOR manipulation, lending, cybersecurity and conflicts of interest. She is a City expert on the FCA's client money and asset rules, having advised clients on FCA enforcement investigations and Section 166 reviews. Most recently, she represented PwC in its successful defence of an FRC investigation into its CASS reports on Barclays Bank, which had been fined £33 million by the FCA for its CASS breaches. Sarah also specialises in the PRA and FCA’s Senior Managers and Certification Regime and has advised over a dozen clients on their implementation of the rules.

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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.

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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.

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