THE SECURITIES LITIGATION REVIEW

FOURTH EDITION

Editor
William Savitt

THE LAWREVIEWS

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CONTENTS

PREFACE

This fourth 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 China, where private securities litigation is complex, expensive, seldom remunerative 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 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 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 has 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 has given 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 divergence and 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 fourth edition, which covers more countries than ever before. 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
June 2018

Chapter 8

ENGLAND & WALES

Karen Anderson and Harry Edwards[1]

I OVERVIEW

i 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 investing 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.

1 Karen Anderson and Harry Edwards are partners at Herbert Smith Freehills LLP. The authors wish to thank Damien Byrne Hill, Phil Clarke, Ian Thomas, Rowan Platt and Ceri Morgan for their assistance in producing this chapter.

2 2014/596/EU.

3 MAR has been directly applicable in the UK (and other Member States of the EU) since 3 July 2016; it replaced most of the national legislation under Part 8 of FSMA, which formerly governed the civil market abuse regime, and the disclosure requirements for listed issuers made under Part 6 of 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).

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]

The FCA also issues 'soft guidance' in a number of forms, which does not have official standing, but nonetheless seeks to influence the behaviour of those it is aimed at, 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.[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, which 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 in the relatively early stages of development in England and Wales, but the most obvious claims that investors in securities may deploy are claims under the statutory liability regimes provided for by FSMA and common law claims in fraud or negligent misstatement. The former give a cause of action for untrue or misleading statements in prospectuses or listing particulars, or the omission of necessary information from such documents, and for recklessly untrue or misleading statements in, dishonest omissions from, or dishonest delay in publishing other information published by issuers of securities. The likely targets for such claims are, naturally, the issuer of the securities, its directors and, in certain circumstances, the professional advisers and other parties involved in the publication of the relevant information.

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

6 The Prudential Regulation Authority also has power to bring administrative enforcement actions, but with the objective of promoting the safety and soundness of the firms it regulates.

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 listing particulars or a prospectus relating to securities contains any untrue or misleading statement or if it fails to include information that is required by statute. Section 87A FSMA sets out the principal requirement that the listing particulars or prospectus includes the information necessary to enable investors to make an informed assessment of the issuer[7] 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: (1) acquired the securities in question; and (2) 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 its contents,[8] as well as those who accept responsibility in the offering document or who authorise its contents.[9] The breadth of this 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.[10] However, the better view is that, so long as the misstatement or omission remains current (i.e., the passage of time, subsequent events or any updated announcements, or both, 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.[11]

7 In particular, its assets and liabilities, financial position, profits and loss and prospects. See also Section 80(1) FSMA.

8 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.

9 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.

10 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'.

11 See J Lightman, obiter, in *Possfund Custodian Trustee Ltd v. Diamond* [1996] 1 WLR 1351 at 1360 discussing the equivalent provision in the statute preceding FSMA, Section 166 of the Financial Services Act 1986. He did not expressly determine the issue because the relevant statutory provision had not been brought in effect, but considered that liability owed to 'any person who has acquired the securities to

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 unnecessary information. In addition to this practical point, one can argue 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).[12] 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. This is also 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 (even putting to one side the issue that many may not even have read the prospectus or listing particulars in full).

A defendant[13] 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 significant of the available defences. For example, is it sufficient to ensure that reasonable processes have been followed in the conduct of due diligence and verification of the contents of the document? How far down the chain of command within the issuer does the investigation need to go for belief to be attributable to the issuer?[14] How easy will it be, often many years after the drafting of the document in

which the prospectus relates' did not extend to the secondary market. See also discussion about liability for aftermarket transactions in *Competition Law* 1998, 19(10), 311–314 and J Payne, '*Possfund v. Diamond*: a reassessment of the common law duty owed to subsequent purchasers who rely on a company prospectus', *JFC* 1997, 4(3), 253–254. The *Possfund* decision has not been considered or applied in the context of Section 90 FSMA.

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

13 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.

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

question, to explain the key judgements 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 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. 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 a 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 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 published information (other than listing particulars or a prospectus) 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 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, in addition to the need for the information to be material for loss to follow, the cause of action requires each investor to establish that their reliance on the defect was reasonable. Moreover, the need to show reliance, in contrast to Section 90, provides a serious hurdle to bringing a claim. In the absence of any court guidance or established techniques for claimants to use to show reliance other than on an individual basis, it will be interesting to observe any attempts to import methods that have been adopted in other jurisdictions to overcome this challenge.[15]

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

15 For example, see the discussion of 'fraud on the market' theory in the US chapter of this book.

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. Whereas the courts have found that statutory auditors did not assume responsibility to the purchasers of shares in the company they audited,[16] 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 EGM),[17] the High Court refused a strike out an application in respect of a common law claim by secondary market purchasers relying on a prospectus.[18] More recently, the High Court has found that an arranging bank assumed responsibility to investors in publicly issued debt securities to ensure that certain transaction documentation had been properly executed[19] (see further under 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.

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.[20] 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.[21] The burden is therefore great but, if that intention is established, a presumption is raised that the investor relied upon it and the burden will shift to the defendant to show that the investor did not, as well as potentially extending limitation periods. This cause of action also gives the investor the advantage that it will be able to recover all of its consequential losses, rather than merely those that were reasonably foreseeable. However, it is likely to be a matter of evidence whether the investor can establish on the facts what its actual counterfactual investments would have been.

16 *Caparo Industries plc v. Dickman* [1990] 2 AC 605.
17 *Sharp v. Blank* [2015] EWHC 3007 (Ch).
18 *Possfund Custodian Trustee v. Diamond* [1996] 1 WLR 1351 HC (Ch).
19 *Golden Belt 1 Sukuk Company v. BNP Paribas* [2017] 3182 (Comm).
20 *Derry v. Peek* [1889] UKHL 1.
21 *Bisset v. Wilkinson* [1927] AC 177 PC 183.

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.[22] 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 AF1*,[23] 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 Appeal[24] 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 long-standing duty to provide existing shareholders with sufficient information for them to make informed decisions about proposals put to them at EGMs.[25]

Breach of regulatory obligations

FSMA establishes a number of statutory claims available to investors who have suffered loss as a result of a breach of FSMA itself or of rules made by the FCA in addition to claims under Section 90 and Section 90A (referred to above). An investor will have a claim where the investment agreement was made with, or through a person who was not authorised by the FCA, but should have been, or where the investment was a result of an unlawful financial promotion.[26]

22 Misrepresentation Act 1967, Section 2(1).

23 [2015] EWHC 871 (Comm).

24 *Taberna Europe CDO II plc v. Selskabet AF1* [2016] EWCA Civ 1262.

25 *Kaye v. Croydon Tramways* [1898] 1 Ch. 358 CA (Civ Div); *Tiessen 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).

26 FSMA, Sections 26, 27 and 30.

Under Section 138D FSMA, a private person[27] will have additional claims available where an authorised person has breached eligible[28] 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 of FSMA.[29] 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.[30] 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.[31]

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,[32] will be confined to relief under Section 90A (and Schedule 10) of 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

27 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.

28 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.

29 *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.

32 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.

prosecutors) may also obtain an order for restitution or compensation for their benefit.[33] 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.[34]

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.[35] 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 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.

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 to bring claims and join the group to make a claim financially viable (or to attract third-party funding). Alternatively, the court could exercise its case-management powers to order that the claims are consolidated or to order that a number of claims that it considers raise common issues are suspended and direct that 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 of doing so. This may extend to any third-party funders who assist in

33 See, e.g., FCA Final Notice of 28 March 2017 in respect of *Tesco plc and Tesco Stores Limited* (*Tesco*).

34 Civil Procedure Rules, Rule 1.1.

35 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.

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[36] 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 breach of requirements under MAR.[37] For the most part, the regulator will have the power to impose sanctions directly where it concludes that a breach has occurred. In those cases, it will issue a decision notice, notifying the firm or individual of its findings and imposing what it considers 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

36 Civil Procedure Rules, Part 36.

37 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).

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,[38] making a false or misleading statement intended to induce someone to invest in securities,[39] creating a false or misleading impression in relation to relevant markets or securities[40] or in respect of benchmarks.[41] 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.[42]

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

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

ii Procedure

Where the FCA decides to commence an enforcement investigation, its first step will be to appoint investigators, who will usually be FCA staff.[43] 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.[44] 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 privileged documents.[45]

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.[46]

Typically, the FCA will follow the process of gathering relevant documents with an interview stage, and 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.[47]

38 Criminal Justice Act 1993, Part V.

39 Financial Services Act 2012, Section 89.

40 Financial Services Act 2012, Section 90.

41 Financial Services Act 2012, Section 91.

42 The FCA and the Crown Office have agreed arrangements for the prosecution of offences in Scotland arising out of FCA investigations.

43 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.

44 Sections 122A–122F in respect of breaches of MAR, and Sections 170–176A FSMA generally.

45 Defined as 'protected items' as described in Section 413 FSMA.

46 Section 122D (for market abuse) and Section 176 FSMA.

47 Section 174 FSMA.

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, and has the power to publish that notice.[48] 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.[49] The findings set out in the decision notice can be challenged by referring the matter to the Upper Tribunal for a fresh hearing,[50] or seeking judicial review by the courts of some flawed aspect of the FCA's process on narrow, public law grounds.[51]

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, typically incentivised to do so by a combination of factors, including reputational concerns, management time and distraction and the availability of a discount of up to 30 per cent to the financial penalty.[52] Individuals facing potential loss of their livelihood 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 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 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 charge to press, 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'.[53]

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

48 Section 67(1)–(3) FSMA.

49 Section 67(4)–(6) FSMA.

50 Section 67(7) FSMA.

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

52 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.

53 See, for example, *R v. Innospec Ltd* [2010] EW Misc 7 (EWCC) (18 March 2010).

corporate defendants.[54] 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.[55]

iv Sentencing and liability

The FCA has powers to impose a broad range of disciplinary penalties and sanctions.

The sanctions most commonly used by the FCA are: fines (with no upper limit on the amount); a public censure; imposing suspensions and restrictions on firms and approved persons; and a private warning.

The FCA has articulated a five-step penalty setting process.[56] 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.[57]

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.[58]

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 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.[59] 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 Financial Instruments Directive or the Markets in Financial Instruments Regulation.[60]

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.

54 Crime and Courts Act 2013, Section 45 and Schedule 17. Although other prosecutors can be designated, this has not as yet occurred.

55 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.

56 DEPP 5.6, DEPP 5.6A-C. The FCA is to consult on revising its penalty process in 2017/18.

57 DEPP 6.5.

58 Section 123A FSMA.

59 Sections 122G and 122F FSMA.

60 See Part 5 of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017, which also make provision for the procedure to be followed and the right of referral.

IV CROSS-BORDER ISSUES

i Private

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

EU-domiciled defendant – the recast Brussels Regulation

The general rule is that the defendant should be sued in his or her place of domicile. Accordingly, a claim against an English domiciled issuer (to which Section 90, Section 90A or one of the tortious claims described above may apply) is likely to be capable of being brought before the English courts (subject to the existence of a contradictory exclusive jurisdiction clause in the applicable documentation that is of binding effect). However, there are a number of important exceptions to this rule whereby, even if the defendant is not domiciled in England and Wales, a claim may nevertheless be brought in the English courts (and that issuers in England and Wales could face claims in the courts of other jurisdictions). The most relevant alternative jurisdiction for a tortious claim is the place where the harmful act occurred, which, pursuant to Article 7(2) of the recast Brussels Regulation, means either: (1) where the damage occurred; or (2) where the events giving rise to the damage occurred. While not free from doubt, the location of (2) is likely to be where the document in question was drafted and distributed. However, for (1), the position is subject to greater uncertainty. The decision of the European Court of Justice (ECJ) in *Kolassa*[61] 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 real link to the matters in dispute. Happily, the position has more recently been clarified by the ECJ in *Universal Music,*[62] 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*).

61 *Kolassa v. Barclays Bank plc* (case C-375/13).

62 *Universal Music International Holding BV v. Schilling* (CC-12/15).

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

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

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

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

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,[63] 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.[64]

The FCA's market abuse jurisdiction

By contrast, the FCA must ensure that the provisions of the Market Abuse Regulation 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:

a admitted to trading on a regulated market or for which a request for admission to trading on such a market has been made;

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;

c that are traded on an organised trading facility (OTF); and

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 at (a) and (b), including, but not limited to, credit default swaps and contracts for difference.

63 Otherwise known as the Treaty on the Functioning of the European Union.

64 Section 169 FSMA.

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.[65]

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.[66]

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.

One of the first Section 90 claims, the *RBS Rights Issue Litigation*, was settled in mid-2017 with the result that there is only limited judicial guidance from that litigation. The claim was originally brought by various groups of retail and institutional investors against Royal Bank of Scotland and its former directors alleging that the bank misled investors by misrepresenting the financial position of the bank and omitting necessary information in its 2008 rights issue prospectus.

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 date 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

65 It is not yet clear what policy decision will be taken about jurisdiction following the UK's exit from the EU, although it seems likely that the UK will adopt an approach similar to the UK regime that predated the European legislation, which sought to capture behaviour which 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.

66 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.

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, which will be of interest much more broadly, including:

a the nature of the duties owed by issuers and their directors in shareholder circulars;
b announcements of transactions and investor presentations;
c the standards of reasonableness applicable to issuers and directors in satisfaction of those duties;
d the role of advisers to issuers;
e materiality questions; and
f the role of risk factors in shareholder documentation and a number of issues relating to the principles of quantum of loss and methodologies of calculation.

One of the most significant decisions in the past year was the decision of the High Court in *Golden Belt*[67] 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 documentation in question was a promissory note issued by the obligor in favour of the issuer in order to provide noteholders with a direct and relatively easy means to enforce a claim against the obligor in the event of a default. In summary, the court justified the findings of a duty of care on the basis that the duty was a specific and limited one and followed the application of established principles regarding the imposition of a duty of care to the specific facts of the case. For instance, much was made of investors' dependence on the arranging bank to perform the role of ensuring the necessary arrangements were made to put in place a valid promissory note in circumstances where investors cannot have been expected to take the risk of those steps not having been satisfactorily carried out. However, there is little doubt that the decision is a controversial one in that it presents a novel extension of the law of negligence in the context of a capital markets transaction 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. In those circumstances, it is perhaps unsurprising that permission to appeal to the Court of Appeal has been granted, and that appeal will be closely watched as a result.

The *Tesco* case is ongoing. In addition, there are a number of claimant firms who have widely advertised to investors to bring proceedings in relation to Volkswagen, Quindell (Watchstone) and BT for widely reported alleged corporate failures. One can see the influence of third-party litigation funders, such as Innsworth, seeking to identify potential claimants; for example, in relation to BT. 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 UKLA 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.

67 *Golden Belt 1 Sukuku Company v. BNP Paribas* [2017] EWHC 3182 (Comm).

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,[68] 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.

On 17 October 2017, the FCA fined Rio Tinto £27,385,400 for breaching the Disclosure and Transparency Rules by failing to carry out an impairment test and to recognise an impairment loss on the value of certain mining assets when publishing its 2012 interim results. According to the FCA, had Rio Tinto complied with its obligation to carry out the test, a material impairment would have been required to have been disclosed at the time of its 2012 half year financial reporting; Rio Tinto's financial reporting was, therefore, deemed inaccurate and misleading.

In December 2017, the FCA fined Tejoori Limited (Tejoori) £70,000 for failing to inform the market of inside information as required by Article 17(1) MAR. This is the first fine the FCA has imposed on an AIM company for late disclosure after the introduction of MAR. Tejoori is a self-managed closed-ended investment company whose shares were traded on AIM between 24 March 2006 and 5 December 2017. One of two material investments was a shareholding in BEKON Holding AG (BEKON) that Tejoori valued in its financial statements at US$3.35 million. The BEKON shareholders' agreement contained a drag-along provision that could be used by majority shareholders to require other shareholders to sell their BEKON shares in the event of a takeover. In July 2016, Tejoori was notified by BEKON about a compulsory acquisition of its shares by Eggersmann Gruppe GmbH & Co KG (Eggersmann): this required Tejoori to sign a share purchase agreement (SPA) and to sell its BEKON shares to Eggersmann for no initial consideration and with only a possibility of receiving deferred consideration that was materially lower than the value of Tejoori's investment in BEKON. The information about the sale to Eggersman was inside information that Tejoori should, under MAR, have disclosed as soon as possible. On 10 August 2016, press releases by both BEKON and Eggersmann announcing the acquisition made no reference to Tejoori, and the market was unaware of the terms, including any consideration paid to Tejoori by Eggersman. The market speculated about the amount that might have been paid to Tejoori, and Tejoori's share price rose sharply on 22 and 23 August. The London Stock Exchange contacted Tejoori's nominated adviser about the price rise, and, based on its misunderstanding of the SPA, Tejoori said that it was not in the possession of inside information and had not sold its shareholding in BEKON. On 24 August 2016, after Tejoori's German legal adviser clarified the position, Tejoori announced the sale of its shares in BEKON, confirming that it received no initial consideration from the sale and that it was unable to assess, at that time, whether it would receive any future consideration. Tejoori's share price closed 13 per cent down on the day of the announcement. This breach of disclosure obligations led to the creation of a false market in Tejoori's shares for the entire relevant period. Investors who traded in Tejoori's shares during that time would have done so on the basis of materially incomplete information, which prevented them from making fully informed investment decisions.

The FCA now expects that firms will have completed an additional technical development required to fulfil MAR surveillance requirements, notably around quote surveillance, and that firms should ensure their surveillance and reporting capabilities keep

68 See footnote 33.

in lock-step with developments in their business. In January 2018, a UK broker was fined £1,049,412 in respect of failings in its post-trade systems and controls for identifying and reporting suspicious transactions in the period February 2014 to February 2015. The UK broker had outsourced surveillance of trades on its venue to a US subsidiary, which had failed to properly design, test and implement adequate systems to monitor for potential market abuse. The FCA considered that the UK broker failed to provide 'effective oversight' of how the US team then reviewed the reports, and to ensure the team were sufficiently trained. As a result, three separate transactions that the FCA considered provided reasonable grounds to suspect market abuse in the form of insider dealing were not reported.[69] The FCA publicly named the firm in a warning notice statement, prior to its formal decision to fine, for the first time.

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 is scheduled for October 2018.

The FCA also decided to prohibit Tom Hayes from performing any function in relation to any regulated activity in the financial services industry, on the basis that he was not a fit and proper person as a result of his conviction for conspiracy to defraud in relation to the manipulation of Yen LIBOR. However, Tribunal proceedings have been deferred on the basis that he has referred his conviction to the Criminal Cases Review Commission (CCRC).

VI OUTLOOK AND CONCLUSIONS

The outlook for private securities actions will be dominated by the progress in the cases referred to in Section V, 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, likely to be handed down this year, will provide judicial guidance on a number of issues of wider application.

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 additional technology and experience from other jurisdictions, including through the involvement of litigation funders, is only likely to increase the risk of issuer-based liability claims in the future. 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. The FCA expects the number of transaction reports captured to increase from around 20 million per day to about 30 to 35 million per day. The volume and details of the data collected under the MAR and MiFID II regimes should allow the FCA to detect serious misconduct as quickly as possible. 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

69 FCA final notice dated 28 January 2018, *Interactive Brokers UK Limited*, https://www.fca.org.uk/publication/final-notices/interactive-brokers-uk-limited-2018.pdf.

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. In October 2017, the FCA's director of enforcement, Mark Steward, referred to an approximate 75 per cent increase in the number of FCA investigations over the past year, attributable both to an increase in data collected by the FCA and to a change in the FCA's approach to deciding whether to open an investigation. 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.

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.

In a speech in November 2017, Julia Hoggett, the head of the department, noted that the FCA's engagement with issuers, sponsors, other industry professionals, advisers and other parties that could hold or generate inside information, suggested that their ability to identify inside information, or indeed when information is not inside information, was 'somewhat patchy'. She also hinted that the very small number of suspicious transaction and order reports submitted to the FCA in relation to non-equity insider dealing and manipulation could be seen as a leading indicator of the industry's (in)ability to identify potentially manipulative behaviour in equity markets and to monitor and perform surveillance for all types of abuse in fixed income and commodity markets.

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.

The FCA also published a 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), which would give the regulator very broad discretion to take enforcement action. This was accompanied by 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. This is a topic that firms will wish to monitor: 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.

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 to be negotiated, 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.

Appendix 1

ABOUT THE AUTHORS

KAREN ANDERSON

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Karen Anderson is a partner working in the financial services regulatory practice at Herbert Smith Freehills LLP. She has lengthy experience in advising a variety of financial institutions, professionals and service providers in the financial services sector on a wide range of contentious and non-contentious regulatory matters including market abuse, wholesale conduct, conflicts of interest, sponsor duties and disclosure rules. Having served a secondment with the regulator and in-house, and through her participation in a range of industry associations, including the BBA market abuse working group, the CLLS regulatory committee, which she chairs, and the Law Society banking reform working group, Karen remains actively involved in discussions with regulators and policymakers regarding the regulation of financial services.

HARRY EDWARDS

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Harry specialises in heavyweight banking litigation matters, primarily for the largest investment and commercial banks. He has recently acted on two of the biggest financial cases in the English courts: the successful defence of a US$1.2 billion claim brought against Goldman Sachs by the Libyan Investment Authority in relation to nine equity derivative transactions entered into by the LIA in the lead up to the financial crisis, and for Lloyds Banking Group (as well as five of its former directors) in defending a claim brought by around 6,000 shareholders in relation to the acquisition of HBOS at the height of the financial crisis, which is proceeding by way of a group litigation order (the English equivalent to class actions) and went to trial in October 2017.

Harry has previously helped UBS in two substantial matters: successfully defending claims brought against it by a start-up hedge fund, Decura, in relation to the termination of a joint venture agreement that the two firms had entered into and in relation to the fallout from the identification of a rogue trader (Kweku Adoboli) incurring losses of US$2.3 billion.

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