THE SECURITIES LITIGATION REVIEW

FIFTH EDITION

Editor
William Savitt

THE LAWREVIEWS

THE SECURITIES LITIGATION REVIEW

FIFTH EDITION

Editor
William Savitt

THE LAWREVIEWS

PUBLISHER
Tom Barnes

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGER
Joel Woods

SENIOR ACCOUNT MANAGERS
Pere Aspinall, Jack Bagnall

ACCOUNT MANAGERS
Olivia Budd, Katie Hodgetts, Reece Whelan

PRODUCT MARKETING EXECUTIVE
Rebecca Mogridge

RESEARCH LEAD
Kieran Hansen

EDITORIAL COORDINATOR
Tommy Lawson

HEAD OF PRODUCTION
Adam Myers

PRODUCTION EDITOR
Caroline Herbert

SUBEDITOR
Tessa Brummitt

CHIEF EXECUTIVE OFFICER
Paul Howarth

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-030-1

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

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

ALLEN & GLEDHILL LLP

BAE, KIM & LEE LLC

BORDEN LADNER GERVAIS LLP

BRUUN & HJEJLE

CHEN & LIN ATTORNEYS-AT-LAW

CMS RUSSIA

CMS VON ERLACH PONCET LTD

DARROIS VILLEY MAILLOT BROCHIER

DE BRAUW BLACKSTONE WESTBROEK NV

HANNES SNELLMAN ATTORNEYS LTD

HERBERT SMITH FREEHILLS

LINDENPARTNERS PARTNERSCHAFT VON RECHTSANWÄLTEN MBB

MORI HAMADA & MATSUMOTO

PINHEIRO NETO ADVOGADOS

RAHMAT LIM & PARTNERS

ROPES & GRAY

RUSSELL MCVEAGH

UGHI E NUNZIANTE STUDIO LEGALE

URÍA MENÉNDEZ

WACHTELL, LIPTON, ROSEN & KATZ

CONTENTS

PREFACE

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 6

ENGLAND AND WALES

Harry Edwards and Sarah Thomas[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 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]

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:

a the Secretary of State for Business, Energy and Industrial Strategy;
b the Director of the Serious Fraud Office (SFO); and
c 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:

a untrue or misleading statements in prospectuses or listing particulars and the omission of necessary information from such documents (Section 90 claims); and
b recklessly untrue or misleading statements, dishonest omissions of required information, or dishonest delay of such information in relation to an issuer's other publications (Section 90A claims).

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 a prospectus or listing particulars[7] 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[8] 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,[9] as well as those who accept responsibility in the offering document or who authorise its contents.[10] 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.[11] 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.[12]

---

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).[13] In any event, a Section 90 cause of action is incomplete without the investor establishing causation and loss, which ought to prevent a successful claim for immaterial information defects.

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[14] 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

Act 1986. He did not expressly determine the issue because the relevant statutory provision had not been brought in effect, but considered that liability owed to 'any person who has acquired the securities to which the prospectus relates' did not extend to the secondary market. See also discussion about liability for aftermarket transactions in Competition Law 1998, 19(10), 311–314 and J Payne, '*Possfund v. Diamond*: a reassessment of the common law duty owed to subsequent purchasers who rely on a company prospectus', JFC 1997, 4(3), 253–254. The *Possfund* decision has not to date been considered or applied in the context of Section 90 FSMA.

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

14 There is a potential question over whether or not the Schedule 10 defences are available to the issuer in addition to natural persons. However, the better view is that they are not restricted to natural persons.

the investigation need to go for belief to be attributable to the issuer?[15] 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

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 executed[19] (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.

17 *Caparo Industries Plc v. Dickman* [1990] 2 AC 605.

18 *Sharp v. Blank* [2015] EWHC 3007 (Ch).

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

20 Another live issue in the *Lloyds/HBOS* litigation.

21 *Derry v. Peek* [1889] UKHL 1.

22 *Bisset v. Wilkinson* [1927] AC 177 PC 183.

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 AF1*,[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 Appeal[25] 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

23 Misrepresentation Act 1967, Section 2(1).

24 [2015] EWHC 871 (Comm).

25 *Taberna Europe CDO II Plc v. Selskabet AF1* [2016] EWCA Civ 1262.

26 *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).

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 person[28] will have additional claims available where an authorised person has breached eligible[29] 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.

30 *Hall v. Cable & Wireless Plc* [2009] EWHC 1793 (Comm).

31 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.

32 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[37] 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.[38] For the most part, the regulator will have the power to impose

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,[39] making a false or misleading statement intended to induce someone to invest in securities,[40] creating a false or misleading impression in relation to relevant markets or securities[41] or in respect of benchmarks.[42] 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.[43]

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

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

ii Procedure

Where the FCA decides to commence an enforcement investigation, its first step will be to appoint investigators, who will usually be FCA staff.[44] 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).[45] 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.[46]

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.[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.[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.[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.[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,[51] or seeking judicial review by the courts of some flawed aspect of the FCA's process on narrow, public law grounds.[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.[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

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

48 Section 174 FSMA.

49 Section 67(1)–(3) FSMA.

50 Section 67(4)–(6) FSMA.

51 Section 67(7) FSMA.

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

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 Brusselss 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 *Kolassa*[62] 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*,[63] 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:

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

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

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

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,[64] 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.[65]

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

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:

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 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]

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*[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*[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

68 *Golden Belt 1 Sukuku Company v. BNP Paribas* [2017] EWHC 3182 (Comm).
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*,[70] 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*,[71] 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*,[72] 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.

Appendix 1

ABOUT THE AUTHORS

HARRY EDWARDS

Herbert Smith Freehills LLP

Harry specialises in shareholder class actions and other heavyweight banking litigation matters for investment and commercial banks. He has recently acted on two of the biggest financial cases in the English courts: the successful defence of a US$1.2 billion claim brought against Goldman Sachs by the Libyan Investment Authority in relation to nine equity derivative transactions entered into by the LIA in the lead up to the financial crisis, and for Lloyds Banking Group (as well as five of its former directors) in 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 (judgment pending).

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.

SARAH THOMAS

Herbert Smith Freehills LLP

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.

HERBERT SMITH FREEHILLS

Herbert Smith Freehills LLP
Exchange House
Primrose Street
London EC2A 2EG
United Kingdom
Tel: +44 20 7374 8000
Fax: +44 20 7374 0888
sarah.thomas@hsf.com
harry.edwards@hsf.com

www.herbertsmithfreehills.com

Law
Business
Research

ISBN 978-1-83862-030-1