UNIVERSITEIT GENT

FACULTEIT RECHTSGELEERDHEID

INVESTOR LOSSES.
A COMPARATIVE LEGAL ANALYSIS OF CAUSATION AND ASSESSMENT OF DAMAGES IN INVESTOR LITIGATION.

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Dissertation in order to obtain the degree of Doctor in Law

Academic Year 2013-2014

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CONTENTS

LIST OF ABBREVIATIONS

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AA	Ars Aequi
AG	Die Aktiengesellschaft
AG	Amtsgericht (Germany)
AJP/PJA	Aktuelle juristische Praxis/Pratique Juridique Actuelle
AktG	Aktiengesetz (German Stock Corporation Act)
Ala. L. R.	Alabama Law Review
Alb. L. Rev.	Albany Law Review
Am. Crim. L. Rev.	American Criminal Law Review
Am. Econ. Rev.	American Economic Review
Am. J. Comp. L.	American Journal of Comparative Law
Am. L. & Econ. Rev.	American Law and Economics Review
Am.L.Rev.	American Law Review
Am. U. L. Rev.	American University Law Review
ALR	Ankara Law Review
ALJB – Bull. Droit & Banque	Association Luxembourgeoise des Juristes De Droit Bancaire – Bulletin Droit & Banque
Ann. Rev. Banking & Fin. L.	Annual Review of Banking & Financial Law
Ariz. L. Rev.	Arizona Law Review
Ariz. St. L. J.	Arizona State Law Journal
Arr. Cass.	Arresten van het Hof van Cassatie
AV&S	Aansprakelijkheid, Verzekering & Schade
B.J.I.B.& F.L.	B.J.I.B.& F.L.
Bank. Fin. R.	Bank en Financieel Recht
Banque et Droit	Revue Banque et Droit
Baylor L. Rev.	Baylor Law Review
Bb	Bedrijfsjuridische Berichten
BB	Betriebsberater
BCC	Belgian Civil Code
Berkeley Bus. L.J.	Berkeley Business Law Journal
BGB	Burgerliches Gesetzbuch (German Civil Code)
BGH	Bundesgerichtshof (German Supreme Court)
BGHZ	Entscheidungen des Bundesgerichtshofs in Zivilsachen
B. C. L. Rev.	Boston College Law Review
BKR	Zeitschrift für Bank- und Kapitalmarktrecht
B.U. L. Rev.	Boston University Law Review
B.Y.U. L. Rev.	Brigham Young University Law Review
Brook. J. Corp. Fin. & Com. L.	Brooklyn Journal of Corporate, Financial, & Commercial Law
Brook. J. Int'l L.	Brooklyn Journal of International Law
Brook. L. Rev.	Brooklyn Law Review
BS	Belgisch Staatsblad (Belgian official journal)
Bull. Ass.	Bulletin des assurances
Bull. Joly Bourse	Bulletin Joly Bourse
Bull. Joly Soc.	Bulletin Joly Sociétés
Bus. L. Int'l	Business Law International

Bus. Law.	Business Lawyer
CA	Cour d'Appel (appellate court in France)
Cal. L. Rev.	California Law Review
Cambridge L.J.	Cambridge Law Journal
Can. Bus. L. J.	Canadian Business Law Journal
Cardozo L. Rev.	Cardozo Law Review
Cass.	Hof van Cassatie/Cour de Cassation (Belgian and French Supreme Court)
CDR	Commercial Dispute Resolution
C.J.Q.	Civil Justice Quarterly
C.M.L.J.	Capital Markets Law Journal
CMLRev	Common Market Law Review
Colum. Bus. L. Rev.	Columbia Business Law Review
Colum. J. Eur. L.	Columbia Journal of European Law
Colum. L. Rev.	Columbia Law Review
Cornell Int'l L.J.	Cornell International Law Journal
Cornell L. Rev.	Cornell Law Review
DAOR	Le droit des affaires/Ondernemingsrecht
DB	Der Betrieb
DCC	Dutch Civil Code
DCCR	Droit de la Consommation - Consumentenrecht
Del. Journ. Corp. L.	Delaware Journal of Corporate Law
Denv. U. L. Rev.	Denver University Law Review
DePaul Bus. & Com. L.J.	DePaul Business and Commercial Law Journal
D&O	Directors and officers
D&O insurance	Directors and officers insurance
Duke L. J.	Duke Law Journal
EBLR	European Business Law Review
EBOR	European Business Organization Law Review
ECFI	European Court of First Instance
ECJ	Court of Justice of the European Union
Edin. L. R.	Edinburgh Law Review
EJRR	European Journal of Risk Regulation
ELJ	European Law Journal
ELR	European Law Review
ELSA Malta L. Rev.	ELSA Malta Law Review
Emory L. J.	Emory Law Journal
Entrepreneurial Bus. L.J.	Entrepreneurial Business Law Journal
ERCL	European Review of Contract Law
ERPL	European Review of Private Law
EU	European Union
Eur. Company & Fin. L. Rev.	European Company and Financial Law Review
Euredia	Euredia: revue européenne de droit bancaire & financier
EuZW	Europäische Zeitschrift für Wirtschaftsrecht
FCC	French Civil Code
Fla. L. Rev.	Florida Law Review
Fordham L. Rev.	Fordham Law Review

FSMA (Belgium)	Financial Services and Market Authority (national supervisor)
FSMA 2000 (UK)	Financial Services and Market Act
Ga. L. Rev.	Georgia Law Review
Geo. Wash. L. Rev.	George Washington Law Review
Geo. L.J.	Georgetown Law Journal
GesKR	Zeitschrift für Gesellschafts- und Kapitalmarktrecht
GLJ	German Law Journal
Griffith L. Rev.	Griffith Law Review
Harv. Int'l L.J.	Harvard International Law Journal
Harv. L. Rev.	Harvard Law Review
HAVE/REAS	HAVE/REAS
HBLR	Harvard Business Law Review
HGB	Handelsgesetzbuch (German Commercial Code)
I.C.L.Q.	International and Comparative Law Quarterly
IER	International Economic Review
IFLR	International Financial Law Review
IJE & P	International Journal of Evidence & Proof
Ind. L.J.	Indiana Law Journal
Int'l Rev L & Econ	International Review of Law and Economics
Iowa L. Rev.	Iowa Law Review
J. Accounting Res.	Journal of Accounting Research
JAE	Journal of Accounting and Economics
JBL	Journal of Business Law
J.B.L.	Juristische Blätter
J. Bus.	Journal of Business
J. Bus. & Sec. L.	Journal of Business & Securities Law
JCLS	Journal of Corporate Law Studies
JCP	Journal of Consumer Policy
JCP II	La Semaine Judiciaire II
JCP-E	La Semaine Juridique Entreprise et Affaires
JCP-G	La Semaine juridique - Edition générale
J. Corp. L.	Journal of Corporation Law
JEL	Journal of Economic Literature
J. Empirical Legal Stud.	Journal of Empirical Legal Studies
JEP	Journal of Economic Perspectives
JETL	Journal of European Tort Law
JFC	Journal of Financial Crime
JFE	Journal of Financial Economics
JFRC	Journal of Financial Regulation and Compliance
JIBFL	Journal of International Banking and Financial Law
JIBLR	Journal of International Banking Law and Regulation
JITE	Journal of Institutional and Theoretical Economics
J. L. & Econ.	Journal of Law and Economics
J.L. Econ. & Org.	Journal of Law, Economics & Organization
JLE	Journal of Legal Economics
J. Legal Stud.	Journal of Legal Studies

JLMB	Revue de jurisprudence de Liège, Mons et Bruxelles
JOR	Jurisprudentie Onderneming en Recht
Journ. Fin.	Journal of Finance
JPIL	Journal of Personal Injury Law
J. Polit. Econ.	Journal of Political Economy
J Priv Int'l L	Journal of Private International Law
JT	Journal des Tribunaux
J. Transnat'l L. & Pol'y	Journal of Transnational law & Policy
Jura Falc.	Jura Falconis
JuS	Juristische Schulung
Kh.	Rechtbank van Koophandel (Commercial Court, Belgium)
Law and Contemp. Probs.	Law and Contemporary Problems
Legal Issues of Econ. Integration	Legal Issues of Economic Integration
Lewis & Clark L. Rev.	Lewis & Clark Law Review
LFMR	Law and Financial Markets Review
LG	Landesgericht (Germany)
Loy. L.A. L. Rev.	Loyola of Los Angeles Law Review
Loy. U. Chi. L.J.	Loyola University Chicago Law Journal
LQR	Law Quarterly Review
LS	Legal Studies
Macquarie L.J.	Macquarie Law Journal
Md. L. Rev.	Maryland Law Review
Mich. L. Rev.	Michigan Law Review
MJ	Maastricht Journal of European and Comparative Law
MLR	Modern Law Review
Mon LR	Monash University Law Review
MvV	Maandblad voor Vermogensrecht
N.C. J. Int'l L. & Com. Reg.	North Carolina Journal of International Law and Commercial Regulation
NIPR	Nederlands Internationaal Privaatrecht
NJ	Nederlands Juristenblad
N.J.W.	Neue juristische Wochenschrift
NJW	Nieuw Juridisch Weekblad
NTBR	Nederlands Tijdschrift voor Burgerlijk Recht
NV	De Naamlooze Vennootschap
Nw. U. L. Rev.	Northwestern University Law Review
NY Law Journal	New York Law Journal
N.Y.U. J. Int'l L. & Pol.	New York University Journal of International Law and Politics
N.Y.U. J. L. & Bus.	New York University Journal of Law & Business
N.Y.U. L. Rev.	New York University Law Review
NZG	Neue Zeitschrift für Gesellschaftsrecht
O&F	Onderneming & Financiering
ÖBA	Zeitschrift für das gesamte Bank- und Börsenwesen
OGH	Der Oberste Gerichtshof (Austrian Supreme Court)
OJ	Official Journal of the European Union
Okla. L. Rev.	Oklahoma Law Review
OLG	Oberlandesgericht (Germany)

Ondernemingsrecht	Ondernemingsrecht
Osgoode Hall L.J.	Osgoode Hall Law Journal
Oxford J. Legal Studies	Oxford Journal of Legal Studies
PA	Petites Affiches
Pas.	Pasicrisie België
P&B/RDJP	Proces & Bewijs/Revue de droit judiciaire et de la preuve
Penn St. L. Rev.	Penn State Law Review
Pepp. L. Rev.	Pepperdine Law Review
PIABA	Public Investors Arbitration Bar Association Bar Journal
P.N.	Tottel's journal of professional negligence
PRIP	Packaged Retail Investment Product
QJE	Quarterly Journal of Economics
RabelsZ	Rabels Zeitschrift für ausländisches und internationales Privatrecht
RABG	Rechtspraak Antwerpen Brussel Gent
Rb	rechtbank van eerste aanleg (Court of first instance)
R.C.J.B.	Revue critique de jurisprudence belge
RD bancaire et bourse	Revue de droit bancaire et de la bourse
RD banc. fin.	Revue de droit bancaire et financier
R.D.D.	Revue Régionale de Droit
Rec. Dalloz	Recueil Dalloz
Rev. accounting studies	Review of accounting studies
Rev.dr. pén.	Revue de droit pénal et de criminologie
Rev. sociétés	Revue des sociétés
RF	Rechtspraak Financieel recht
RFS	Review of Financial Studies
R.I.W.	Recht der internationalen Wirtschaft
R.G.D.A.	Revue générale des assurances et des responsabilités
RGDA	Revue générale du droit des assurances
RJEP	Revue juridique d l'économie publique
r.o.	rechtsoverweging (consideration in Dutch court decisions)
RTD Fin.	Revue trimestrielle de droit financier
RvdW	Rechtspraak van de Week
RW	Rechtskundig Weekblad
S. Cal. L. Rev.	Southern California Law Review
Seton Hall L. Rev.	Seton Hall Law Review
SJ II	Semaine Judiciaire II
SJ	Semaine Judiciaire
SJZ/RSJ	Schweizerische Juristenzeitung
SZW/RSDA	Schweizerische Zeitschrift für Wirtschafts- und Finanzmarktrecht
SJLS	Singapore Journal of legal studies
Stan. J.L. Bus. & Fin.	Stanford Journal of Law, Business & Finance
Stan. L. Rev.	Stanford Law Review
STB	Staatsblad van het Koninkrijk der Nederlanden (Dutch official journal)
St. John's L. Rev.	St. John's Law Review
Sup. Ct. Econ. Rev.	Supreme Court Economic Review
TBBR	Tijdschrift voor Belgisch Burgerlijk Recht

TBH	Tijdschrift voor Belgisch Handelsrecht
Temp. Int'l & Comp. L.J.	Temple International and Comparative Law Journal
Tex. Int'l L.J.	Texas International Law Journal
TFR	Tijdschrift Financieel Recht
T.F.R.	Tijdschrift voor Financieel Recht
THRHR	Journal of Contemporary Roman-Dutch Law
TvI	Tijdschrift voor Insolventierecht
TPR	Tijdschrift voor PrivaatRecht
T. comm.	Tribunal commercial (Commercial court, France)
T. corr.	Tribunal correctionel (France)
TRV	Tijdschrift voor Rechtspersoon en Vennootschap
TvC	Tijdschrift voor Consumentenrecht en handelspraktijken
TvOB	Tijdschrift voor vennootschapsrecht, rechtspersonenrecht en ondernemingsbestuur
T.Verz.	Tijdschrift voor Verzekeringen
TVVS	Maandblad voor ondernemingsrecht en rechtspersonen
Tul. L. Rev.	Tulane Law Review
UCLA L. Rev.	UCLA Law Review
U. Chi. L. Rev.	University of Chicago Law Review
U. Cin. L. Rev.	University of Cincinnati Law Review
U. Ill. L. Rev.	University of Illinois Law Review
U. Miami L. Rev.	University of Miami Law Review
U. Pa. J. Bus. L.	University of Pennsylvania Journal of Business Law
U. Pa. L. Rev.	University of Pennsylvania Law Review
U. Pitt. L. Rev.	University of Pittsburgh Law Review
Utah L. Rev.	Utah Law Review
Va. J. Int'l L.	Virginia Journal of International Law
Va. L. Rev.	Virginia Law Review
Vand. L. Rev.	Vanderbilt Law Review
V&F	Vennootschapsrecht en Fiscaliteit
V&O	Vennootschap en Onderneming
Vermogensrechtelijke analyses	Vermogensrechtelijke analyses
Vill. L. Rev.	Villanova Law Review
Vt. L. Rev.	Vermont Law Review
Wake Forest L. Rev.	Wake Forest Law Review
Wash. & Lee L. Rev.	Washington and Lee Law Review
Wash. U. L.Q.	Washington University Law Quarterly
Wis. L. Rev.	Wisconsin Law Review
with ann. by	with annotation by
WM	Wertpapier-Mitteilungen
Wm. & Mary L. Rev.	William and Mary Law Review
WPNR	Weekblad voor Privaatrecht, Notariaat en Registratie
Yale J. on Reg.	Yale Journal on Regulation
Yale L.J.	Yale Law Journal
Yale Rev.	Yale Review
ZBB	Zeitschrift für Bankrecht und Bankwirtschaft

ZGR	Zeitschrift für Unternehmens- und Gesellschaftsrecht
ZHR	Zeitschrift für das gesamte Handels- und Wirtschaftsrecht
ZIP	Zeitschrift für Wirtschaftsrecht
ZZPInt.	Zeitschrift für Zivilprozess International

INTRODUCTION & RESEARCH AGENDA.

I. Introduction

1. Under EU impulse and following the Financial Services Action Plan (FSAP) in 1999[1], capital market law has developed into a distinct and extensive branch of law in the EU Member States. As cross border financial transactions in the pre-FSAP era often resulted in the application of a complex patchwork of national rules and provisions, the FSAP mainly intended to create the necessary legal framework that would allow for the harmonization of national financial laws. EU legislation following the FSAP particularly focused on the elimination of the so-called 'multiple jurisdiction problem' that arose in case market participants operated on a cross border basis. The 'multiple jurisdiction problem' more particularly arose when the laws of various Member States applied and caused, and to some extent still cause, market participants to factor in the different legal systems and (sometimes redundant) national legal provisions that may apply to their activities. Throughout the European integration of financial markets, it was envisioned to reduce legal uncertainty associated with the 'multiple jurisdiction problem' and increase the level of market efficiency and competition by widening the access to national financial markets and transform those markets into one single EU market. More particularly, unrestrained by differing national regulations, investors and suppliers of investment products and services have easier access to the market, while a greater choice in products and services is unlocked and drives competition, which results in reduced costs of capital.[2]

2. To achieve these goals, extensive sets of legislation were promulgated at the EU level under the Lamfalussy structure, which can be described as a method consisting of a multi-layered structure with four levels, each focusing on a different stage in the process of EU law-making and implementation.[3] First level legislation consists of framework directives comprising the core principles and implementing powers, adopted by means of the co-decision procedure. The Prospectus Directive[4],

[1] Commission Communication, 'Implementing the framework for action on financial services: action plan', 11 May 1999, COM (1999) 232. For an overview of the different stages in financial law harmonization, see: R. VEIL, *Europäisches Kapitalmarktrecht*, Tübingen, Mohr Siebeck, 2011, 2; N. MOLONEY, *EC Securities Regulation*, New York, Oxford University Press, 2008, 11 ff., 79 ff.

[2] MOLONEY, *EC Securities Regulation*, 53; M.B. FOX, 'Civil liability and mandatory disclosure', 109 *Colum. L. Rev.*, 2009, no. 2, 264 ff., and the references cited in ftn. 73. In its white paper on financial services 2005-2010, the European Commission resolves to remove the remaining economically significant barriers so services can be provided and capital can circulate freely throughout the EU at the lowest possible cost (EC, White Paper Retail Financial Services 2005-2010, COM(2005) 629 final, 3).

[3] E. FERRAN, *Building an EU securities market*, Cambridge, Cambridge University Press, 2004, 61-84; O.O. CHEREDNYCHENKO, 'European securities regulation, private law and the investment firm-client relationship', 5 *ERPL*, 2009, 928-929. For a detailed overview, see: R. PANASAR and P. BOECKMAN, *European Securities Law*, New York, Oxford University Press, 2010, 1.03-1.15; E. AVGOULEAS, 'A Critical Evaluation of the New EC Financial-Market Regulation: Peaks, Troughs, and the Road Ahead', 18 *The Transnational Lawyer*, 2005, 184; L. ENRIQUES and M. GATTI, 'Is There a Uniform EU Securities Law After the Financial Services Action Plan?', 14 *Stan. J.L. Bus. & Fin.*, 2008, iss. 1, 44 ff; P.-H. VERDIER, 'Mutual recognition in international finance', 52 *Harv. Int'l L.J.*, 2011, iss. 55, 72 ff.; R. VEIL (ed.), *European capital markets law*, Oxford, Hart Publishing, 2013, 6.

[4] Directive 2003/71/EC Of The European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, *OJ* L 345/64, as amended by Directive 2010/73/EU of the European parliament and of the council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are

the Transparency Directive[5], the MiFID[6] and Market Abuse Directive[7] are prominent examples of FSAP-directives and form the key components of the EU securities law, generally referred to as 'framework directives'. These directives provide for a general regulatory framework within which more detailed and technical rules are adopted by the Commission following advice by sector specific committees (level two regulation).[8] These committees also provide level three regulation, being guidelines, recommendations and standards directed at national competent authorities to ensure consistent implementation of the level one and two legislation and coordination of the supervisory practices between the various Member States.[9] The fourth level of the Lamfalussy structure consists of the European Commission enforcing the transposition of European legislation into national law and effecting continuous reviews of the legislative framework.[10] These reforms and the legislation enacted following the FSAP changed the European financial landscape significantly, and continue to do so in

admitted to trading on a regulated market, *OJ* 2010 L 327/6 (Prospectus Directive). See also: VEIL, *Europäisches Kapitalmarktrecht*, 27 ff.

[5] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, *OJ* L 390/38 (hereinafter: 'Transparency Directive'). The directive is to be revised, a proposal to this end has been submitted and is pending: Proposal for a Directive of the European Parliament and of the Council amending Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and Commission Directive 2007/14/EC, COM(2011) 683 final, available at http://ec.europa.eu.

[6] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, *OJ* L 145/1 (hereinafter: 'MiFID'). MiFID is to be revised in the near future. With regard to potential amendments: European Commission, 'Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council' (Recast), COM(2011) 656 final, 20 October 2011, http://ec.europa.eu/internal_market (MiFID II).

[7] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), *OJ* L 96/16, (hereinafter: 'Market Abuse Directive'). The Market Abuse Directive is to be repealed and substituted by the Market Abuse Regulation (Regulation (EU) of the European Parliament and the Council on insider dealing and market manipulation). The political agreement on the new Market Abuse Regulation has been endorsed by the European Parliament on 10 September 2013 but it is noted that the offical press release on the Parliament's endorsement states that the "final adoption of the Market Abuse Regulation would take place after a final political agreement on MiFID II." The reason for this alignment with MiFID II lies with the fact that certain aspects of the Market Abuse Regulation (notably its scope) depend on the final text of MiFID II "and these will need to be aligned", according to the European authorities. It was also stated that the date as of which the new market abuse rules would apply is to be aligned with MiFID II. See in this regard: European Commission, Memo, European Parliament's endorsement of the political agreement on Market Abuse Regulation, 10 September 2013, Brussels, available at http://europa.eu/rapid/press-release_MEMO-13-774_en.htm. The Market Abuse Regulation is also to be supplemented by an additional directive in the nearby future: European Commission, 'Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation', COM(2011) 654 final, 20 October 2011, available at: http://ec.europa.eu/ (hereinafter: 'MAD II-proposal'). The latter will include rules on criminal sanctions for market abuse contrary to the rules included in the Market Abuse Regulation.

[8] See for example Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, *OJ* L 149/1, with regard to implantation measures to the Prospectus Directive; or Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, *OJ* L 241/26 with regard to MiFID transposition measures.

[9] Since January 1st, 2011, the committees responsible for the proper implementation of EU financial law are the European Securities and Markets Authority ("ESMA", that succeeded the Committee of European Securities Regulators or "CESR), the European Insurance and Occupational Pensions Authority ("EIOPA", which succeeded the Committee of European Insurance and Occupational Pensions Supervisors or "CEIOPS) and the European Banking Authority (or "EBA", that succeeded the Committee of European Banking Supervisors or "CEBS").

[10] Although the four levels of legislation of the Lamfalussy structure continue to exist, there have been some changes due to recent reforms and changes following the Lisbon Treaty and the formation of ESMA. See in this regard: VEIL (ed.), *European capital markets law*, 34-35, para. 29-35.

the post-FSAP era with revisions and recasts of the four framework directives[11] and other legislation, such as UCITS[12], EMIR[13] and the AIFMD[14], and new legislative initiatives such as the proposal for a regulation on packaged (retail) products and derivatives.[15] National financial law has not only been harmonized throughout these evolutions, but was also broadened and deepened, generating a more modern financial legal framework within which the EU single market can further develop.

3. The mere enactment of an extensive body of rules does not suffice to realize the goals pursued by the EU harmonization project, however. Adequate enforcement mechanisms constitute a necessary corollary to ensure compliance with the rules and the effectiveness of the regulatory system as a whole. Finding that the financial crisis of 2007-2008 revealed that existent enforcement mechanisms ran short of their goals in securing solid, liquid and stable financial markets, structural and fundamental reforms took place at the national and the European level in the field of financial supervision and public enforcement of financial law. Private enforcement mechanisms on the other hand have received considerably less attention, although private actors and private enforcement mechanisms may also contribute to the overall effectiveness and soundness of the regulatory system. More particularly, considering the importance attached to investor empowerment and investor protection in European and national capital market law, the role private enforcement and investor litigation plays and may play to realize these goals and complement public enforcement actions is worthy of closer attention.

II. Research questions, scope and structure of the research

4. **Research questions.** – The possibility to obtain compensation for investor losses has gained substantial importance and attention in recent years as capital markets across Europe have increasingly attracted smaller investors who have substituted traditional savings products offered by banks for more risk-bearing financial products traded on financial markets. As a result, a growing number of retail investors have entered the financial markets causing policymakers to consider the appropriateness of the existent legal framework within which these (often unsophisticated) investors operate. As

[11] The revision of the Prospectus Directive was completed in 2010 by the enactment of Directive 2010/73/EU of the European parliament and of the council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, *OJ* L 327/6 (Directive 2010/73/EU). With regard to the other directives, i.e. MiFID and the Transparency Directive, proposals have been submitted. Proposals for MiFID II and the Transparency Directive are pending (ftn. 5 and 6).The Market Abuse Directive was repealed by the Market Abuse Regulation on Market Abuse (MAR) (see ftn. 7).

[12] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, *OJ* L 302/32 (UCITS). A proposal for the revision of this directive is pending: Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions, COM(2012) 350 final, available at http://ec.europa.eu (UCITS-V-proposal).

[13] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, *OJ* L 201/1(EMIR).

[14] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) 1095/2010, *OJ* L 174/1 (AIFMD).

[15] See for instance the proposal for a regulation concerning packaged retail investment products (PRIPS): European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012/0169, 352 final, Brussel 3 July 2012, available at http://eur-lex.europa.eu; and with regard to derivatives: Proposal for a Regulation of the European Parliament and of the Council on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories, COM(2011) 652 final, available at http://ec.europa.eu (MiFIR).

ZINGALES and MOLONEY point out, the interest on the political level for retail investors entering the markets is motivated by general policy, efficiency and fairness considerations, but also relates to the role financial markets have come to play in the provision of individual wealth, especially in terms of pension and retirement plans.[16] The increasing dependence of retail investors on financial markets, investing household savings through financial intermediaries and collective investment funds for retirement purposes, as well as the increasing number of investors directly entering the market, has rendered the design of an adequately protective legal framework necessary.[17] A challenging problem in this regard concerns the problem of mis-selling of financial products and misleading information disclosed to individual investors or the market as a whole, causing investors to invest or trade in instruments based on incomplete or inaccurate information and a lack of understanding of the risks involved. For instance, as a consequence of the internet-bubble at the end of the '90s and the worldwide financial crisis in 2008-09, many investors suffered considerable investment losses for which redress was demanded in national courts. A considerable amount of investor litigation concerned claims based on allegations of mis-selling of unsuitable financial products or misleading information that caused investors to fail to understand the nature and the risks of the products they were investing in.

5. Aware of the importance of investor protection and investor confidence as a means to foster sustainable growth and more solid financial markets, EU capital market law has strongly underlined the need for rules aimed at the strengthening of the position of (retail) investors vis-à-vis professional market participants, the prevention of mis-selling and the promotion of market transparency. Besides prudential and organizational rules, EU law therefore also contains extensive sets of information obligations, rules of conduct and market disclosure regulation. A regulatory framework that aims to protect investors and enable them to reach informed and suitable investment decisions is thus in place. Yet the question arises to what extent these investors are entitled and empowered to privately enforce these rules once violations have occurred and investors suffer losses as a result. Even though the subject of private enforcement of capital market law and investor litigation has increasingly drawn attention in the scholarly literature over the last few years, the notions of causation and recoverable loss in the context of defective investment services and deficient market disclosures have remained somewhat neglected, despite findings in reported case law and scholarly literature that investors often struggle to obtain compensation due to these requirements. Drawing on these findings, this thesis investigates the conceptualization of the notions of causation and recoverable loss in the context of investor suits for defective investment services and deficient market disclosures, and seeks to contribute to a more consistent and better delineated concept of causation and loss in the context of investor litigation. In order to present the research in a structured and orderly fashion, the thesis has been organized in parts and chapters that each deal with a subset of research questions.

[16] L. ZINGALES, 'The Future of Securities Regulation', 47 *J. Accounting Res.*, 2009, iss. 2, 391-392; N. MOLONEY, *How to protect investors: lessons from the EC and the UK*, Cambridge, Cambridge University Press, 2010, 3.

[17] Idem. For an overview of the historical developments in retail investors presence on EU financial markets, consult: N. MOLONEY, *How to protect investors*, 2 ff. See on this topic also: N. MOLONEY, 'Regulating the Retail Markets: Law, Policy, and the Financial Crisis', in G. LETSAS and C. O'CINNEIDE (eds.), *Current Legal Problems*, Oxford, OUP, 2010, vol. 63, 375; J. WESTRUP, 'Independence and Accountability: Why Politics Matters', in D. MASCIANDARO and M. QUINTYN (eds.), *Designing Financial Supervision Institutions*: *Independence, Accountability and Governance,* Northhampton, Edward Elgar, 2007, 127 ff.; IMF, Ageing and pension system reform: implications for financial markets and economic policies, G10, 2005, available at http://www.imf.org.

6. **Part I. –** Since the Member States' capital markets laws have been largely shaped by the rules enacted at the EU level, the research sets out with a concise overview of the relevant European legislation (Chapter I). Drawing from the European capital market legislation and its underlying goals and paradigms with regard to investor protection, the second chapter aims to clarify whether EU law has affected the Member States' national private laws with regard to investor litigation, and to what extent private rights of actions and the requirements of causation and loss may have been impacted. It is also discussed if and to what extent the European legislator is authorized to set such requirements in the light of its legislative competences and the division of powers between the EU level and the Member States. The analysis is not limited to the European legislation as such, but also considers the role of the EU courts. It is particularly examined if and to what extent the EU courts have interfered in this area of law, and may (continue to) do so in the future.

Building on these findings, the first part concludes with an overview and discussion of the private rights of action on which investors can rely to privately enforce violations of (often EU –originated) capital market law according to the Member States' national private laws (Chapter III). Considering these rights of action, the analysis particularly concentrates on the interpretation and the application of the requirements of causation and recoverable loss, and the calculation of compensatory damages. The focus on the requirements of causation and recoverable loss is especially interesting and relevant as reported case law shows that investors often struggle to obtain compensation because of these requirements. Additionally, an analysis of the relevant case law also demonstrates a lack of consistency in the application of causation and loss in the context of investor litigation. The chapter concludes with setting out the general principles and framework within which causation and loss are to be assessed in the context of investor losses.

7. **Part II and Part III. –** The second and third part of the thesis contain a detailed study on the application of the concepts of causation and recoverable loss in two subsets of investor litigation, being claims for defective investment services on the one hand, and litigation for deficient market disclosures on the other hand. The second part particularly focuses on the requirement of (transaction) causation in the context of defective investment services, while the second chapter elaborates the concept and assessment of recoverable loss and issues relating to the calculation of the damages. The third and final part of the thesis then examines the assessment of causation and loss in the context of deficient market disclosures. Whilst the first chapter discusses the application of causation and loss in line with the traditional model applied in the national courts, the second chapter investigates the application of an alternative model that has been developed and applied in the US courts, drawing on insights from financial economic theory. The model is assessed on its merits and effectiveness and considers the implications of its potential application in the Member States' national private laws.

8. The choice for a detailed analysis of the concepts of causation and loss in these two areas of investor litigation (i.e. claims for defective investment services and litigation for deficient market disclosures) is based on several reasons. First of all, as this thesis focuses on the interaction between EU originated investor protection law and its impact on the national private laws, the choice for these two areas of law is logical. Both the regulation on investment services and market disclosures have been promulgated on the European level and implemented in the national legal frameworks, while both sets of rules have also been considered vital to strengthen the position of (retail) investors. Second, as will be explained and demonstrated in the first part of the thesis, underlying these sets of rules is the recurrent purpose to reduce information asymmetries and allow investors to make well-informed decisions on investments and transactions in line with their individual preferences and objectives. While the rules of conduct and (often extensive) information obligations aim to tend to this goal in the context of investment services, market disclosure obligations aim to inform the market and provide market participants with all relevant information to trade and operate in sound, efficient and transparent financial markets. The question arising in this thesis therefore concerns the question to what extent investors can recover losses when they make particular investment decisions they may not have made, or may have made under different conditions, in case these rules have not been complied with and may have misled the investor.

Finally, the subject of financial services and investment product distribution has taken a central place on the regulatory agenda of both the European and national legislator as the financial crisis of 2007-2008 taught that the regulatory framework as it stood prior to the crisis ran short of preventing mis-selling of financial products on large scale, indicating the existence of a structural problem in the distribution chain. Besides the promulgation of additional rules tightening the legal framework within which financial intermediaries operate, the role of private enforcement and investor litigation as a means to enhance investor confidence and overall compliance has drawn increased attention too. The same can be said with regard to the enforcement of market disclosures. Considering that a higher degree of enforcement may contribute to the overall effectiveness of the rules and an increased level of investor protection, private enforcement of wrongful market disclosures has increasingly gained interest at both the national and the EU level too.

III. Methodology

9. The research involves an analysis of the European capital market legislation, concentrating on its underlying goals and paradigms with regard to investor protection and investor empowerment. Focusing on the question to what extent European capital market law has impacted the means of redress available to investors, the European legislative texts are analyzed, complemented with an analysis of the relevant scholarly literature and reported case law of the EU courts. Once it is clarified to what extent the European level influences the Member States' national private laws with regard to investor redress, the national laws of several Member States are analyzed with a focus on the conceptualization and application of the requirements of causation and loss. Since the concepts of causation and loss have generally not been clarified in national legislative provisions, case law analysis is of major importance in this examination. An analysis of available case law not only clarifies the nature and scope of the difficulties and inconsistencies in the courts' analysis of causation and loss, but may also offer insights on the solutions that were developed and to what extent these solutions add to the effectiveness of the liability rules in the context of investor litigation.

10. In addition to extensive literature studies and case law analysis, the research also involves comparative analysis of the legal systems of a selection of Member States. The comparative analysis focuses on five EU jurisdictions in particular, being Belgium, Germany, France, the UK and the Netherlands. The choice for these countries is based on the fact that these countries are longstanding members of the EU and have calibrated their capital market legal frameworks after the European requirements, while preserving their own private law system within which notable differences may exist. Each of these countries was found to have a minimum of reported case law available for research, which allows drawing conclusions and offers insights on the questions set out in the previous paragraphs. Yet the research is not confined to these legal systems as useful doctrines and relevant insights are also gathered from studying other Member States and jurisdictions beyond the borders of the EU, such as the US and Switzerland. For instance, finding that the reported case law on investor litigation in the context of asset management generated by Swiss courts offers relevant insights and perspectives, these insights are discussed when relevant for the analysis. Furthermore, as the US legal doctrine has far more experience with investor compensation models derived from financial-economic theory, the US model is analyzed in the final chapter of the thesis. The analysis is further complemented with case law and scholarly literature from Luxembourg, Austria and Italy whenever relevant. The thesis states the law and state of play in the case law as at 10 September 2013.

PART I. PRIVATE ENFORCEMENT OF EU CAPITAL MARKET LAW: EU AND NATIONAL LEGAL FRAMEWORKS

CHAPTER I. EU CAPITAL MARKET LAW FROM AN INVESTOR PROTECTION PERSPECTIVE: LEGAL FRAMEWORK AND PARADIGMS

11. The European legal framework of capital market law contains prudential, organizational and investor protection rules. As the subject of this thesis concerns the private enforcement of investor protection rules, this chapter concentrates on and is limited to the investor protection framework promulgated by the EU legislator to enhance and protect investors looking for (suitable) investments by directly trading on regulated markets or, more indirectly, through professional investment firms. From this perspective, the overview below aims to offer insights on the purpose and effect of these investor protection rules, the regulatory changes taking place in this regard and the insights and evolutions driving those changes. As will be demonstrated, the provision of information to markets and investors is of overriding importance in the European legal framework and takes a central place in EU capital market legislation.

I. Rational investors, allocative efficiency and the role of information

12. Investor protection, investor confidence and market efficiency. – Along with the overarching market integration purpose and other goals, such as financial and systemic stability, equal access to markets, market transparency, and market integrity, investor confidence and investor protection have become increasingly important themes in EU capital market law directives.[18] The key assumption underlying the importance attached to investor confidence and investor protection asserts that besides sufficient supply of products and services, sufficient demand for these products and services is equally vital to the development of solid, efficient financial markets. In order to foster sufficient demand, it is widely believed that the more investors trust a market, the more willing they are to invest and the more capital will be made available. This in turn reduces the cost of capital substantially and enhances allocative efficiency allowing for the realization of more valuable investment projects.[19] Put differently, as investor protection and investor confidence are closely

[18] Investor protection is mentioned as one of the main objectives of the Prospectus Directive (rec. (10), (16), (18), (19), (20), (21) and repeated in the 2011 directive amending the Prospectus Directive (rec. (3)), the Market Abuse Directive (Preamble (12) and (24)) and the future Market Abuse Regulation (rec. (1) and (8), as well as in art. 1), the Transparency Directive (inter alia rec. (5), (7) and (10)) and MiFID (inter alia rec. (2), (17), (31) and (44)). For an illustration see for instance: rec. (1) Transparency Directive: "Efficient, transparent and integrated securities markets contribute to a genuine single market in the Community and foster growth and job creation by better allocation of capital and by reducing costs. […] This enhances both investor protection and market efficiency". See also: ESME, Report on Directive 2003/71, 2007, p. 10; EC, Green Paper on Retail Financial Services, (COM)2007 226 final, available at: http://ec.europa.eu, 2. See furthermore: MOLONEY, *EC Securities Regulation*, 98; ENRIQUES and GATTI, 'Uniform EU Securities Law', 47 ff. MOLONEY, *How to protect investors*, 8 ff., 48 ff.; N. MOLONEY, 'Confidence and Competence: the Conundrum of EC Capital Markets Law', 4 *JCLS*, 2004, 7; G. SCHAEKEN WILLEMAERS, *The EU Issuer-Disclosure Regime: Objectives and Proposals for Reform*, Alphen aan den Rijn, Kluwer Law International, 2011, 44; A. HELLGARDT, *Kapitalmarktdeliktsrecht*, Tübingen, Mohr Siebeck, 2008, 166 ("Am Anfang jedes Kapitalmarktrechts steht der Schutz der Anleger.").

[19] The link between the availability of regulation strengthening the position of investors on the one hand, and the cost of capital on the other hand has since long been underlined in the US literature. See for instance in a seminal contribution: F. EASTERBROOK and D.R. FISCHEL, 'Mandatory disclosure and the protection of investors', 70 *Va. L. Rev.*, 1984, at 673: "Fraud reduces allocative efficiency. So too does any deficiency of information. Accurate information is necessary to ensure that money moves to those who can use it most effectively and that investors make optimal choices about the contents of their

associated with the overall objective of market integration, market efficiency and lower costs of capital, investor protection rules have taken a prominent place in EU capital market law. The link between market efficiency, financial market development and investor confidence does not only characterizes EU capital market law, but has been at the core of US securities legislation too.[20]

13. Rational investor and information paradigm. – Underlying this regulatory approach is the paradigm of the rational investor, who decides on the allocation of capital in a rational manner, based on the information about the products and services available and his individual preferences.[21] More particularly, according to the rational investor-model, investors have well-defined preferences and objectives, seek and analyze available information and then decide how to allocate their resources.[22] The first and foremost problem investors may encounter from this perspective concerns information asymmetries vis-à-vis professional suppliers of products and services.[23] More particularly, when investors lack relevant information, it is impossible for investors to make informed assessments and decisions with regard to the products and services offered on the market, rendering them unwilling to invest out of fear from being exploited by other, better informed market participants. Hence, information asymmetries reduce the willingness of investors to invest in the market, which results in increased costs of capital. More particularly, finding themselves unable to distinguish between the various products and services offered on the market in terms of quality and other characteristics, allocative efficiency is seriously threatened as efficient or trustworthy suppliers of products and services cannot reveal themselves to buyers causing market failures to arise. As a result, market participants will show reluctance to enter the market, demand a higher price in terms of risk premiums or attempt to remedy their lack of information by gathering information themselves.[24] Efforts and resources spent on these information gatherings are redundant as the same information is being collected and analyzed countless times by numerous market participants. Having the issuer produce reliable and credible information (as so-called 'cheapest cost avoider') with easy access for all market participants reduces the costs of investing and allows for more resources being invested in the markets,

portfolios. A world with fraud, or without adequate truthful information, is a world with too little investment, and in the wrong things to boot." See also (more recently) amongst others: Z. GOSHEN and G. PARCHOMOVSKY, 'The essential role of securities regulation', 55 *Duke L. J.*, 2006, 771; PANASAR and BOECKMAN, *European Securities Law*, 10, para. 1.22; VEIL (ed.), *European capital markets law*, 18-19, para. 6-7; L. KLÖHN, 'Preventing Excessive Retail Investor Trading under MiFID: a behavioural Law & Economics Perspective', 10 *EBOR* 2009, 438-439.

[20] See more extensively: ZINGALES, 'The Future of Securities Regulation', 391. See also: MOLONEY, *How to protect investors*, 47 ff.; J.J.A. BURKE, 'Re-examining investor protection in Europe and the US', 16 *Murdoch University Electronic Journal of Law*, 2009, nr. 2, 8; MOLONEY, 'Confidence and Competence', 8.

[21] L. STOUT, 'The investor confidence game', 68 *Brook. L. Rev.*, 2002-2003, 407; G. SPINDLER, 'Behavioural Finance and Investor Protection Regulations', 34 *JCP*, 2011, 317; BURKE, 'Re-examining investor protection in Europe and the US', 1; SCHAEKEN WILLEMAERS, *EU Issuer-Disclosure Regime*, 36.

[22] See for instance: rec. (1) Transparency Directive: "[…] The disclosure of accurate, comprehensive and timely information about security issuers builds sustained investor confidence and allows an informed assessment of their business performance and assets. This enhances both investor protection and market efficiency"; art. 5 (1) Prospectus Directive: "the prospectus shall contain all information […] necessary to enable investors to make an informed assessment." Similar: rec. (44) MiFID: "With the two‑fold aim of protecting investors and ensuring the smooth operation of securities markets, it is necessary to ensure that transparency of transactions is achieved".

[23] It is repeated that these insights were originally developed in the US literature. Reference can particularly be made to the widely acclaimed contribution by AKERLOF in which it was asserted that when a market is characterized by informational problems precluding buyers from distinguishing between high quality products and low quality products, distrust and fear for being exploited will make buyers on the market reluctant to transact. Since investors will be unwilling to pay the highest prices out of fear of buying inferior products at such prices, suppliers of the highest quality products will be driven out of the market, with market failure as a result. Information asymmetries are in other words detrimental to allocative efficiency on markets. G. AKERLOF, 'The market for lemons: quality uncertainty and the market mechanism', 84 *QJE*, 1970, 488-500.

[24] *Ibid.*, 488.; see also: E.F. FAMA and A.B. LAFFER, 'Information and capital markets', 44 *J. Bus.*, 1971, 289; EASTERBROOK and FISCHEL, 'Mandatory disclosure', 674.

lowering the overall cost of capital.[25] Investor confidence from the perspective of the rational investor-model thus requires easy access to relevant information that empowers investors to make informed decisions. The insights drawn from the rational investor-model and the potential impact of information asymmetries on financial markets, have resulted in the common view by academics, legislators and supervisory authorities on both sides of the Atlantic that equal and easy access to financial information guarantees an efficient investor protection system, as is also clearly illustrated in various EU capital market law directives.[26] As illustrated below, European capital market law regulates the supply chain from top to bottom, covering public offerings of financial instruments, secondary market trading of securities, market abusive practices that may occur and the distribution of financial instruments through financial services offered to the public. The vast belief in information obligations to empower investors is clearly discernible in these rules.

II. Issuer disclosure obligations

A. Elimination of information asymmetries in EU capital market law

14. Primary market disclosure obligations: prospectus information. – The issuer disclosure regulation imposed by EU securities law is relatively extensive and detailed. With respect to EU primary market regulation for instance, the Prospectus Directive requires issuers planning on offering transferable securities to the public or applying for admission to a regulated market in the European Economic Area to publish a prospectus.[27] In line with the information paradigm, it is stated that prospectuses should contain all information necessary for investors to make an informed decision.[28]

[25] K.J. HOPT and H.C. VOIGT, 'Grundsatz- und Reformeprobleme der Prospekt- und Kapitalmarktinformationshaftung', K.J. HOPT and H.C. VOIGT, *Prospekt- und Kapitalmarktinformationshaftung*, Tübingen, Mohr Siebeck, 2005, 113.

[26] See for instance: rec. (18) Prospectus Directive: "The provision of full information concerning securities and issuers of those securities promotes, together with rules on the conduct of business, the protection of investors. Moreover, such information provides an effective means of increasing confidence in securities and thus of contributing to the proper functioning and development of securities markets."; and rec. (21): "Information is a key factor in investor protection". See also: Commission Communication, 'Implementing the framework for action on financial services: action plan', 11 May 1999, COM (1999) 232. See in this context also: IOSCO, 'Objectives and Principles of Securities Regulation', 2010, available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf, at p. 5, para. 4.2.1. See also the CESR/ESMA annual reports, for instance: ESMA, annual report 2010, available at: http://www.esma.europa.eu, p. 92. See also on the access to information as an investor protection measure (in the context of company law, including capital market law): S. GRUNDMANN (ed.), *European Company Law. Organization, Finance and Capital Markets*, Cambridge, Intersentia, 2011, 17. Furthermore: R. SEBASTIÁN and J. TORTUERO, 'Prospectus liability under the Spanish Securities Market Act: a comparison between the New Spanish Regime and the US regime', *JIBLR*, 2006, iss. 6, (331) 332; SCHAEKEN WILLEMAERS, *EU Issuer-Disclosure Regime*, 27 ff.; C.P. BUTTIGIEG, 'An Evaluation of the Theories and Objectives of Financial Regulation Post the 2007-2009 Financial Crisis: A European Perspective', *ELSA Malta L. Rev.*, 2012, also available at SSRN: http://ssrn.com/abstract=2121334, p. 15, 27 ff.; SPINDLER, 'Behavioural Finance and Investor Protection Regulations', 318; MOLONEY, *EC Securities Regulation*, 98; The latter author notes that investor confidence remains a 'notoriously nebulous objective' in the light of the EU disclosure regime. See with regard to the US for similar remarks: ZINGALES, 'The Future of Securities Regulation', 391.

[27] The prospectus directive applies to a variety of transferable securities, including shares, obligations and units issued by collective investment undertakings of the closed-end type (art. 3 in conjunction with art. 2 (1) (a) Prospectus Directive). The Prospectus Directive distinguishes between professional investors and retail investors, exempting offers exclusively made to qualified investors, offers to fewer than 150 persons per Member State, and offers addressed to investors who acquire securities for a total of at least €100.000 per investor. Art. 3 (2) (c) and (d) Prospectus Directive. Note that the initial threshold of €50.000 was found inadequate to distinguish between professional and retail investors in terms of capacity and has hence been increased to €100.000 following the 2010 revision of the Prospectus Directive (rec. (9) Directive 2010/73/EU of the European parliament and of the council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, *OJ* 2010 L 327/6).

[28] See also rec. (19) Prospectus Directive: "Investment in securities, like any other form of investment, involves risk. Safeguards for the protection of the interests of actual and potential investors are required in all Member States in order to

The information to be provided to the public includes information on the securities offered, the issuer, its business, historic financial information, its financial position and prospects.[29] The information obligations are set out in further (technical) detail by the implementing level two directives.[30] These directives provide for detailed information rules organized in schedules and building blocks in their annexes.[31] Depending on the type of securities offered and/or the transaction for which the prospectus is prepared, different schedules or building blocks apply.[32]

15. In addition to these extensive and specialized information duties, the Prospectus Directive also contains an obligation to provide for a (brief) summary in which key information addressing retail investors is provided.[33] Key information comprises essential and appropriately structured information that enables investors to understand the nature and risks of the issuers and securities that are being offered and allows investors to decide which offers of securities to consider in more detail.[34] The rationale to include a prospectus summary draws on the insight that retail investors generally fail to read and understand the lengthy, detailed prospectuses that often contain technical language. Therefore, the summary should be kept short, not exceeding 2.500 words, and written in non-technical language.[35] The summary is to convey the essential characteristics and risks associated with the issuer, any guarantor and the securities'.[36] However, no liability is attached on the basis of the summary as such, unless it is misleading, inaccurate or inconsistent when read together with other parts of the prospectus.[37] Since no civil liability can be imposed for information solely contained in the summary, investors are thus expected to read the whole prospectus and decide on the investment on the basis of the whole package of information.[38]

16. Secondary market disclosure obligations. – Once an issuer has been admitted to a regulated market, the secondary market disclosure obligations contained in the Transparency Directive and the

enable them to make an informed assessment of such risks and thus to take investment decisions in full knowledge of the facts."

[29] Art. 5 (2) Prospectus Directive. For a detailed discussion of the Prospectus Directive, see amongst others: P. SCHAMMO, *EU Prospectus Law*, New York, Cambridge University Press, 2011 385p.; D. VAN GERVEN 'General provisions of Community law relating to the prospectus to be published when securities are offered to the public or admitted to trading', D. VAN GERVEN, *Prospectus for the public offering of securities in Europe*, I, New York, Cambridge University Press, 2008, 32 ff.

[30] See for instance: Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, *OJ* L 149/1.

[31] Since the preparation of a prospectus constitutes a considerable cost and time-consuming exercise, especially for to the so-called small and medium-sized enterprises (SME's), the Commission enacted an adjusted, proportionate disclosure regime for this type of issuers. The threshold triggering the obligation to prepare a prospectus prior to public offerings has been increased as well in the amending directive. Both these measures were driven by the Commission's aim to reduce some of the unnecessarily burdensome obligations that were highlighted in the Commission's Review of the Prospectus Directive and have been contained in art. 3 (2) (1) and art. 7 (2) (e) Prospectus Directive.

[32] More extensively: VAN GERVEN 'General provisions of Community law', 35 ff.

[33] Art. 5 (2) Prospectus Directive; rec. 15 Directive 2010/73/EU.

[34] Art. 2 (1) (s) Prospectus Directive accommodates a definition of key information and the elements it should contain.

[35] Rec. (21) Prospectus Directive. Exceptions to the 2.500 word limit are accepted when necessary. See in this regard for instance the policy of certain supervisors to allow lengthier summaries when it concerns particularly complex securities etc. See in this regard: VEIL (ed.), *European capital markets law*, 232, para. 36.

[36] Art. 2 (1) (s) Prospectus Directive.

[37] Art. 6 (2) Prospectus Directive. The resistance against such liability for the content of the summary is (partly) the result of the potential language problem, since much information included in the prospectus itself must be omitted from the summary while also inaccessible in the prospectus document itself to those investors who do not master the language used in the latter. More extensively on the prospectus summary and the key information document suggested in the context of UCITS and PRIPs: L. BURN, 'KISS, but tell all: short-form disclosure for retail investors', 5 *C.M.L.J.*, 2010, no. 2 141-168.

[38] Art. 5 (2) Prospectus Directive.

Market Abuse Directive apply. The Transparency Directive establishes two types of ongoing disclosure duties. First, issuers are required to provide continuous financial information by means of annual and half-year reports.[39] The annual reports comprise audited financial statements, a management report on the past and expected future development of the business and financial statements on the assets, liabilities, financial position and profit or loss of the issuer.[40] Every six months, interim management reports and condensed financial statements must be disclosed too.[41] Furthermore, the directive also obliges the disclosure of major holdings of financial instruments.[42] In addition to the Transparency Directive, the Market Abuse Directive also requires issuers to immediately and publicly disclose any inside information that directly concerns the issuer. The requirement to immediately disclose new, price sensitive ad-hoc information aims to adequately and timely inform the investor public, while it may also help to prevent the occurrence of insider trading as it limits the amount of time insiders may have to wrongfully exploit privileged information.[43]

17. The importance of market integrity and market efficiency and its dependence on adequate and timely information disclosures is repeatedly stressed in both the Market Abuse Directive and the Transparency Directive.[44] Rather than focusing on the impact of the disclosures on individual (retail) investor decisions, the language of the ongoing disclosure obligations seems predominantly concerned with the transparent and orderly functioning of the market and the protection of the price formation process (see further below) in general.[45] Yet some references reveal that, again, it is assumed that reasonable and rational investors, including retail investors, generally consult all available information prior to making investment decisions, including continuous information disclosed in accordance with the Market Abuse Directive (and future Market Abuse Regulation) and the Transparency Directive.[46]

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[39] Art. 4-5 Transparency Directive.

[40] Art. 4 Transparency Directive.

[41] Art. 5 Transparency Directive.

[42] The proposal for the revised Transparency Directive holds that major holdings in all financial instruments that that could be used to acquire economic interest in listed companies and have the same effect as holdings of equity should be disclosed. Art. 1 (8) (a) Proposal for a Directive of the European Parliament and of the Council amending Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and Commission Directive 2007/14/EC, COM(2011) 683 final, available at http://ec.europa.eu, proposing an amendment of art. 13 Transparency Directive.

[43] Art. 6 Market Abuse Directive (art. 12 (1) Market Abuse Regulation). See also: G.T.J. HOFF, *Openbaarmaking van koersgevoelige informatie*, Deventer, Kluwer, 2011, 217; J.L. HANSEN and D. MOALEM, 'The MAD disclosure regime and the twofold notion of inside information: the available solution', 4 *CMLRev*, 2009, iss. 3, 330; M.M. SIEMS, 'The EU Market Abuse Directive: A Case-Based Analysis', *LFMR*, 2008, No. 2 39-49; GRUNDMANN (ed.), *European Company Law. Organization, Finance and Capital Markets*, 560; C. VILLIERS, *Corporate reporting and company law*, Cambridge, Cambridge University Press, 2006, 190.

[44] Rec. (1) Transparency Directive; rec. (2) Market Abuse Directive and rec. (2), (26) Market Abuse Regulation.

[45] Idem. See also: MOLONEY, *How to protect investors*, 364, stressing that efficient price formation and cross-border capital-raising are the predominant goals of the issuer disclosure regime.

[46] Rec. (11) Transparency Directive ("This Directive introduces more comprehensive half-yearly financial reports for issuers of shares admitted to trading on a regulated market. This should allow investors to make a more informed assessment of the issuer's situation"); Rec. (25) Transparency Directive states that all investors should have equal access to periodic disclosures, regardless of the member state they are in, and that these disclosures should be open to consultation and accessible at affordable prices for retail investors. Rec. (11) Market Abuse Regulation: "Reasonable investors base their investment decisions on information already available to them, that is to say, on ex ante available information. Therefore, the question whether, in making an investment decision, a reasonable investor would be likely to take into account a particular piece of information should be appraised on the basis of the ex ante available information." See in this regard also: MOLONEY, *EC Securities Regulation*, 99. VILLIERS notes that this measure is aimed at helping to remove information asymmetries that disproportionately affect retail investors. VILLIERS, *Corporate reporting and company law*, 191. The directive hence assumes that retail investors follow up periodic disclosures to make informed investment decisions. See also: MOLONEY, *How to protect investors*, 364-365.

The emphasis placed on the accessibility and processability of periodic issuer disclosures from the perspective of retail investors is illustrative in this regard.[47]

18. Disclosure vis-à-vis retail investors: criticism. – This brief presentation of issuer disclosure rules shows that issuer disclosure obligations are considered a tool to enable investors, including retail investors, to make informed investment decisions. In order to assess the effectiveness of the disclosure rules, however, two sides of the medal must be taken into account. More particularly, although it is clear that the supply side is regulated into considerable detail by regulators, the disclosure model can only then make a difference if the receiving side is equally meeting the expectations, which implies that investors must actually take the effort of reading and processing the information prior to reaching a decision.[48] Reports and observations in this regard have recurrently confirmed that retail investors generally lack the knowledge, background and time to process the considerable information packages that come with products and services they consider to acquire or make use of.[49] As a result, these investors generally do not read financial information, nor are all retail investors generally capable to understand the often quite technical details, even if they would take time and make effort to do so.[50] In this respect, reference can also be made to the study on the impact of the EU prospectus regime carried out by the Centre for Strategy & Evaluation Services (CSES).[51] The study particularly reported that rather than using the prospectus for informational purposes to reach informed investment decisions, retail investors rather use it at as an *ex post* legal document in case it turns out that the issuer has used the prospectus to depict an overly favorable image of the company to stimulate the sale of the offered

[47] Rec. (25) Transparency Directive. See also: MOLONEY, *How to protect investors*, 364 ff.; VILLIERS, *Corporate reporting and company law*, 191; and the references in the previous ftn.

[48] J.R. MACEY, 'A pox on both your houses: Enron, Sarbanes-Oxley and the debate concerning the relative efficacy of mandatory versus enabling rules', 81 *Wash. U. L.Q.*, 2003, 329-331.

[49] H. KRIPKE, 'The myth of the informed Layman', 28 *Bus. Law.*, 1973, 631-639; H. KRIPKE, 'New Approaches to Disclosure in Registered Security Offerings: A Panel Discussion', 28 *Bus. Law.*, 1973, 505-536; H. KRIPKE, 'A search for a Meaningful Securities Disclosure Policy', 31 *Bus. Law.*, 1975, 293-318. See also: G. PEARSON, 'Reconceiving Regulation: financial literacy', 8 *Macquarie L.J.*, 2008, 45-58; P. HALPERN and P. PURI, 'Reflections on the Recommendations of the Task Force to Modernize Securities Legislation in Canada: A Retail Investor Perspective', 45 *Can. Bus. L. J.*, 2008, 214 ff.; *Comp.*: G. GALLERY and N. GALLERY, 'Rethinking financial literacy in the aftermath of the global financial crisis', 19 *Griffith L. Rev.*, 2010, No. 1 30-50; R.G. NEWKIRK, 'Sufficient Efficiency: Fraud on the Market in the Initial Public Offering Context', 58 *U. Chi. L. Rev.*, 1991, 1393; SCHAEKEN WILLEMAERS, *EU Issuer-Disclosure Regime*, 35 ff.; MOLONEY, *How to protect investors*, 290 ff. and references cited.

[50] See extensively: EASTERBROOK and FISCHEL, 'Mandatory disclosure', 669 and 694 in particular, holding that the argument for mandatory disclosure as a means to equalize access to the markets and simplify the presentation of information so all can understand it, is "as unsophisticated as the investors it is supposed to protect."; See in this regard also: ZINGALES, 'The Future of Securities Regulation', 408-409; and the references cited in the previous footnote.

[51] The Centre for Strategy & Evaluation Services (CSES) completed the study in response to a request for services in the context of the Framework Contract for Evaluation and Impact Assessment of Internal Market DG activities: CSES, Study on the Impact of the Prospectus Regime on EU Financial Markets, 2008, June, available at http://ec.europa.eu/internal_market/securities/prospectus/index_en.htmp, 78p.

securities.[52] In line with these findings, the information paradigm has been criticized as being ineffective with regard to retail investors in the scholarly literature too.[53]

19. Investor sophistication and financial literacy. – In an attempt to respond to criticism and mitigate the problems, the EU and organizations such as OECD and IOSCO started developing methods to increase financial literacy levels of unsophisticated investors.[54] Although still debated amongst (legal) scholars, the effectiveness of these educational programs and strategies remains doubtful. Even though positive results have been attributed to these initiatives by some[55], the overall impact is considered to remain rather limited and, at best, yield improvements on the long term only.[56] Another measure taken following concerns about the overload of financial information has been the division of information into various tiers, differing in comprehensiveness, detail and technicality. The prospectus summary containing key investor information is an example of how regulators have tried to set different levels of information provisions depending on the type of consumer or investor. The key investor information document in UCITS (and future PRIPs) is a similar example of short-form disclosures specifically aimed at retail investors (see below).

20. Insights from behavioralism. – Investor sophistication, or the lack thereof, is not the only problem undermining the effectiveness of the current regulatory approach, however. Developments in behavioral science – in which cognitive processes are being studied – have increasingly revealed the

[52] CSES, Study on the Impact of the Prospectus Regime on EU Financial Markets, 2008, June, available at http://ec.europa.eu/internal_market/securities/prospectus/index_en.htmp, 54. Also cited in: MOLONEY, *How to protect investors*, 371. For an example of investors not reading the prospectus, yet using it *ex post* to file claim: Kh. Brussel, 28 January 2011, *Bank. Fin. R.,* 2011, nr. 6, 363. In this Belgian court decision, the investor – an industrial company with experienced and professional personnel deciding on its investments – had made substantial investments in CDO's issued by a Belgian bank. However, the plaintiff had not consulted the prospectus until long after the investment started to lose considerable value and around the time the first complaints concerning the investment were formulated. In this case though, the plaintiff proved unsuccessful for the court considered the wrongdoing not established. See on this decision also: E. WYMEERSCH, Regulation and Case law relating to Financial Derivatives, 2012, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1988925, 14.

[53] From a US perspective: GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 71. In a similar sense from an EU perspective: SCHAEKEN WILLEMAERS, *EU Issuer-Disclosure Regime*, 46 ff.; see also (from the perspective of financial consumers): CHATER, HUCK and INDERST, 'Consumer Decision-Making', 3 acknowledging that the consumer empowerment model should be adjusted in the light of consumers' bounded rationality. See also ftn. 50.

[54] See for instance the activities of the Expert Group on Financial Education, information to be consulted at: http://ec.europa.eu/internal_market/finservices-retail/capability/. See also the initiatives of the French '*Institut pour l'éducation financière du public*' (http://www.lafinancepourtous.com/**)** and the UK initiative: Building Financial Capability in the UK (http://www.fsa.govuk/library/communication/pr/2001/152.shtml). For an overview, consult: M. HABSCHICK, B. SEIDL, J. EVERS, D. KLOSE and Y. PARSIAN, 'Survey of Financial Literacy Schemes in the EU27', November 2007, available at: http://ec.europa.eu/internal_market/finservices-retail/docs/capability/report_survey_en.pdf (108 p). Initiatives undertaken with regard to the enhancement of consumers' financial literacy are not a solely EU-phenomenon though. See for instance with regard to Australia: G. PEARSON, *Financial services law and compliance in Australia*, Sydney, Cambridge University Press, 2009 350-351 for detailed information, consult: http://www.financialliteracy.govau/media/218312/national-financial-literacy-strategy.pdf; ANZ Survey of Adult Financial Literacy in Australia, November 2005, available at: http://www.anz.com; http://www.commbank.com.au; IOSCO, 'Objectives and Principles of Securities Regulation', 11; OECD, *Recommendation on principles and good practice for financial education and awareness*, July 2005, available at: http://www.oecd.org/dataoecd/ (7p.); see also: PEARSON, 'Reconceiving Regulation: financial literacy', 45-58; MOLONEY, *How to protect investors*, 374 ff.; N. MOLONEY, 'Effective policy design for the retail investment services market: challenges and choices post FSAP', F. FERRARINI and E. WYMEERSCH, *Investor protection in Europe: corporate law making, the MiFID and beyond*, 441, New York, Oxford university press, 2006, 427 ff.

[55] OECD, *OECD Policy brief: the importance of financial education*, 2006, 5.

[56] MOLONEY, *How to protect investors*, 375; SCHAEKEN WILLEMAERS, *EU Issuer-Disclosure Regime*, 46; and a report issued by the Australian financial market supervisor (Australian Securities and Investments Commission or 'ASIC'): ASIC, 'Financial literacy and behavioural change', March 2011, report 230, consulted at: http://www.financialliteracy.gov.au/, 4; N. CHATER, S. HUCK and R. INDERST, European Commission, 'Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective. Final Report', November, 2010, http://ec.europa.eu, 40, para. 75. For a critical assessment, consult also: BURN, 'KISS, but tell all: short-form disclosure for retail investors', 159-160.

limits of the rational investor-model and the related information paradigm, demonstrating that investor behavior shows systematic departs from rational behavior, referred to as behavioral biases, and that investor rationality is bound as a result.[57] These behavioral biases cause people to show inconsistent, not calculated behavior causing them to misjudge important information or facts and take irrational, emotional and impulsive decisions.[58] For instance, it has been observed that when confronted with an overload of information, investors simply fail to process all the information made available to them and lose oversight of what is relevant, ending up worse than they would have had without any information and trusting their intuition in some cases.[59] Other research shows that biases, such as the over-confidence bias, herding behavior and other similar cognitive limits distort investor rationality as well, rendering disclosure as such ineffective to eliminate information asymmetries and enable investors to make informed decisions.[60]

21. Summarized, the current regulatory approach with a strong focus on issuer disclosure obligations as a means to eliminate information asymmetries is challenged when it comes to its effectiveness vis-à-vis retail investors.[61] It has particularly been asserted that the focus on retail investors imposes a considerable cost on issuers without justifiable results since the information hardly reaches the retailers, let alone that they are apt to process the information adequately.[62] As a result, this approach has fueled criticism for its inefficiency and its consumer-like approach towards investors in both the EU and the US. PARCHOMOVSKY & GOSHEN for instance reject the assumption that securities law effectively protects or can effectively protect the common investor. Instead, these commentators argue that securities regulation should concentrate on so-called information traders, that is, sophisticated professional investors and analysts.[63] It is more particularly argued that other than common (or retail) investors, information traders do read and process the available information and contribute significantly to market efficiency by trading in response to disclosures, as discussed in more detail in the next section. Hence, as issuer disclosure plays a crucial role with regard to market

[57] Behavioral finance uses insights from psychology, and specifically cognitive psychology, to explain human behavior. Different from the classical liberal economical model that assumes rationality drives human behavior, behavioral finance has focused on explanations for irrational behavior, for instance as a result of certain biases. To the extent these biases occur systematically, irrational human behavior can be explained and sometimes even predicted. See in this regard also: KLÖHN, 'Preventing Excessive Retail Investor Trading', 437; SPINDLER, 'Behavioural Finance and Investor Protection Regulations', 321 ff. see also: VEIL (ed.), *European capital markets law*, 66.

[58] The FCA report discussing the impact of behavioral biases on financial consumer behavior in the context of financial services is instructive in this regard: K. ERTA, S. HUNT, Z. ISCENKO and W. BRAMBLEY, 'Applying behavioural economics at the Financial Conduct Authority', April 2013, FCA Occasional Paper No. 1, 71p. The report identifies inherent complexity of financial products, trade-offs between present and future (discounting), assessing risk and uncertainty, emotions such as stress, anxiety, fear of losses and regret affecting decisions and supplanting a rational analysis of costs and benefits, limited learning effects with regard to some products (p. 5). See also the annex offering a structured overview.

[59] T. PAREDES, 'Blinded by the light: information overload and its consequences for securities regulation', 81 *Wash. U. L.Q.*, 2003, 418 ff., 442.

[60] KLÖHN, 'Preventing Excessive Retail Investor Trading', 437.

[61] See in this regard also: ZINGALES, 'The Future of Securities Regulation', 408-409; GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 71; SCHAEKEN WILLEMAERS, *EU Issuer-Disclosure Regime*, 46 ff.; CHATER, HUCK and INDERST, 'Consumer Decision-Making', 3; EASTERBROOK and FISCHEL, 'Mandatory disclosure', 669 and 694 and the references cited in ftn. 49.

[62] Idem.

[63] GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 711. In a similar manner, SCHAEKEN WILLEMAERS encourages the EU legislator to move away from the consumerism in EU securities law holding that the financial consumer is not only poorly, but also very inefficiently protected by the current issuer disclosure regime (SCHAEKEN WILLEMAERS, *EU Issuer-Disclosure Regime*, 47).

transparency, efficiency and price formation, these purposes are believed to offer a far more pertinent and important justification for the extensive set of disclosure rules than (retail) investor protection.[64]

B. *Market disclosure in the light of market efficiency and the price building process of securities*

22. As the Transparency Directive and the Market Abuse Directive clearly indicate, mandatory market disclosures are not exclusively, and often not even predominantly, aimed at eliminating information asymmetries to enable individual retail investors to make informed investment decisions.[65] These directives also recurrently refer to market efficiency, market integrity and price formation as the underlying rationale for issuer disclosure obligations.[66] More particularly, by providing a continuous flow of information the market can correspondingly adjust securities prices, as is asserted by the financial-economic efficient capital market hypothesis ("ECMH").[67] The ECMH particularly asserts that in an efficient market all relevant information with respect to the securities traded is reflected in its price.[68] The interaction between information and securities pricing is explained by the fact that following disclosures that reveal new information, professional and expert market participants (e.g. professional traders, institutional investors etc.) who read and process the information, may consider securities under- or overpriced in the light of the new information. As a result, they will respond to the information by trading in the securities, which affects supply and demand and hence the price of the security.[69] As long as the price of the security is considered under- or overvalued by market participants based on the information they have at their disposal, trading will continue and prices will adjust to the available information. A continuous stream of information thus supports the securities pricing system and allows securities prices to incessantly reflect available information.[70] As a result of this process, investors are protected by credible and reliable market disclosures on a supra-individual level in terms of efficient pricing mechanisms.[71]

Although the ECMH has been criticized in the light of behavioral finance demonstrating the impact of investor irrationality on securities pricing, a criticism that gained considerable weight in the light of the financial crisis, the theory has remained highly influential, not in the least because no

[64] Idem.

[65] Rec. (1) Transparency Directive; rec. (2) Market Abuse Directive and rec. (2), (26) Market Abuse Regulation.

[66] MOLONEY, *EC Securities Regulation*, 97; VEIL (ed.), *European capital markets law*, 211; MOLONEY, *How to protect investors*, 290.

[67] E. FAMA, 'Efficient capital markets: a review of theory and empirical work', 10 *Journ. Fin.*, 1970, 383-417; J.N. GORDON and L.A. KORNHAUSER, 'Efficient markets, costly information and securities research', 60 *N.Y.U. L. Rev.*, 1985, 834; R.J. GILSON and R. KRAAKMAN, 'The mechanisms of market efficiency', 70 *Va. L. Rev.*, 1984, 549-644.

[68] To qualify as an efficient market, it is required that the security prices reflect the available information; see: FAMA, 'Efficient capital markets', 383-417; GORDON and KORNHAUSER, 'Efficient markets', 834; GILSON and KRAAKMAN, 'The mechanisms of market efficiency', 549-644. The concept 'efficient market' was defined as follows by the Court of Appeal in PolyMedica Corp. Securities Litigation: "[…], we adopt the prevailing definition of market efficiency, which provides that an efficient market is one in which the market price of the stock fully reflects all publicly available information. By "fully reflect," we mean that market price responds so quickly to new information that ordinary investors cannot make trading profits on the basis of such information. This is known as "informational efficiency." We reject a second and much broader meaning of "fully reflect," known as "fundamental value efficiency," which requires that a market respond to information not only quickly but accurately, such that the market price of a stock reflects its fundamental value" (PolyMedica Corp. Securities Litigation, 432 F.3d 1 (1st Cir. 2005)).

[69] See GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 723 ff.

[70] The ECMH is discussed in detail in one of the following chapters.

[71] VEIL (ed.), *European capital markets law*, 217.

comprehensive alternative models have been advanced.[72] Notwithstanding the fact that it has been clearly demonstrated that there are limits to the rational investor-model, behavioral finance has also been criticized as some of the biases and insights it has identified seem to conflict with each other. Secondly, even though behavioral finance has revealed the limits of the rational investor paradigm and the ECHM, so far it has not succeeded in offering a unified, alternative theory explaining human – and investor – behavior.[73] As a result, the insights delivered by the behavioral finance literature may offer a different perspective and add corrections and adjustments to the current model, but it is unable to replace the current model (yet).[74]

Hence, with regard to the purpose and effectiveness of issuer disclosure obligations, it can be concluded that whereas the EU market disclosure obligations fail to adequately remedy information asymmetries at the retail investor level, it does provide sophisticated investors – such as institutional and professional traders – with the required input to maintain an efficient pricing mechanism and enhance overall market transparency.

III. Distribution of financial instruments through intermediaries: information obligations and rules of conduct

23. Whereas the aforementioned directives aim to regulate the issuance and subsequent selling and reselling of financial instruments on secondary markets, MiFID targets the distribution of financial instruments via financial intermediaries to the investor public. MiFID more particularly covers the provision of financial services such as individual investment advice, asset management and execution only services. UCITS and the AIFMD on the other hand provide the legal framework within which collective investment products and funds are provided. In addition to authorization and operational requirements, both directives also contain information obligations and other protective rules, such as the MiFID rules of conduct. The legal framework supporting the distribution of financial products and services through intermediaries is concisely discussed in the next paragraphs and concentrates on the rules that aim to enable investors to find suitable investments and make informed decisions.

A. Collective investment funds regulated by UCITS

24. UCITS is often referred to as the legal framework within which the institutionalization of the retail markets takes place as it allows retail investors to access capital markets through pooling their (limited) funds and invest diversified, while reducing the overall costs as a result of synergies of scale.[75] UCITS applies to undertakings that pool investor assets – either via a corporate or contractual form and represented by either shares or units – to be collectively invested in diversified portfolios

[72] MOLONEY, *EC Securities Regulation*, 97; KLÖHN, 'Preventing Excessive Retail Investor Trading', 448, pointing out that biases identified in behavioral finance sometimes appear contradictory with the result that it is unclear which of these insights can be relied on; D.A. SKEEL, Behavioralism in Finance and Securities Law, 2013, U of Penn, Institute for Law and Economics, Research Paper no. 13-25, available at http://papers.ssrn.com, noting that "[t]he Achilles heel of behavioral economics was the difficulty of distilling it to a single, coherent methodology. […] as one legal scholar put it a decade ago, "behavioral economics has not (and may not ever) develop a single theory that explains or predicts the full range of human behavior, as rational choice theory claims to do." The absence of a unifying theory is not a prerequisite for taking behavioralism's findings seriously, of course, but it did impede acceptance of the new approach" (p.1). For a discussion of the criticism on the ECMH, see also *infra*, 408 ff.

[73] KLÖHN, 'Preventing Excessive Retail Investor Trading', 448.

[74] *Ibid.*, 448 ff.

[75] See in this regard: MOLONEY, *EC Securities Regulation*, 231.

managed by professional investment trusts or companies that operate on the principle of risk-spreading.[76] The publicly raised capital is invested in transferable securities or in other liquid financial assets defined in the directive.[77] UCITS aims to regulate the products offered through these funds, while it also sets authorization and operational standards.[78] As UCITS is aimed at retail investment vehicles, a prospectus should be drawn up aimed at informing potential investors adequately and completely.[79] The rules governing the issuance and contents of a prospectus under UCITS are fairly similar to the rules comprised in the Prospectus Directive.

25. In addition to the standard prospectus, a short document containing key investor information for investors must be prepared as well, to provide investors with a summarized version of the most relevant information.[80] The key investor information reminds of the summary required in prospectuses prepared by issuers or offerors with regard to securities to be traded or admitted to regulated markets, as discussed earlier.[81] In line with the prospectus summary, no civil liability can be incurred following misrepresentations in the key investor information, unless the key investor information is misleading, inaccurate or inconsistent with the relevant parts of the prospectus.[82] As was the case with the prospectus summary, key investor information aims to inform (retail) investors with regard to the essentials and allow them to decide whether or not to consider the investment and inform themselves in more detail on a particular investment.

B. The Alternative Investment Fund Managers Directive (AIFMD)

26. While UCITS regulates collective investment undertakings, the AIFMD applies to the non-UCITS fund sector, in particular hedge funds, private equity funds and real estate funds. Simplified, UCITS has been considered to regulate collective investments to the retail market, whereas the AIFDM targets the institutional and professional investor market segment.[83] Essentially, investment funds that are not regulated by UCITS will be governed by the AIFMD. Different from UCITS, AIFMD does not mainly involve product regulation, but instead regulates the alternative investment fund manager. An alternative investment fund is defined as a collective investment undertaking that raises capital from a number of investors in order to invest it according to a defined investment policy for the benefit of those investors, and that is not regulated by UCITS.[84] The directive aims to ensure investor protection by providing investors with comprehensive information on the objectives and strategy employed by the fund, the fees charged and expenses and the main legal implications of the

[76] Art. 1 (2) UCITS.

[77] Art. 1 (n) and art. 1 (2) (a) in conjunction with art. 50 (1) UCITS.

[78] One of the most important rules for instance prescribes the mandatory diversification of products in which the investors' assets are invested. See more extensively: MOLONEY, *How to protect investors*, 152.

[79] Art. 68 (1) a) UCITS.

[80] Art. 78 (1) UCITS.

[81] See *supra*, para. 15. For an extensive discussion and comparison: BURN, 'KISS, but tell all: short-form disclosure for retail investors', 141-168.

[82] Art. 79 (2) UCITS. It is noted that the PRIPS-proposal (discussed further below, para. 38 ff.) contains provisions governing civil liability following deficient key investor information. See in this regard: European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012/0169, 352 final, Brussel 3 July 2012, available at http://eur-lex.europa.eu.

[83] For a more detailed discussion in this regard: U. KLEBECK, 'Interplay between the AIFMD and the UCITSD', D. ZETZSCHE, *The alternative investment fund managers directive*, Alphen aan den Rijn, Kluwer, 2012, 84 in particular.

[84] Art. 4 AIFMD.

contractual relationship entered into for the purpose of the investment.[85] To the extent the fund managers provides investment services such as portfolio management, investment advice and order execution, the rules of conduct as laid down in MiFID apply (see below).[86] Similar to the UCITS, the AIFMD requires the appointment of a single independent depositary, a key concept in the AIF structure and functioning.[87] By separating asset management functions from safe-keeping the fund's assets while also imposing monitoring tasks on depositaries, the AIFMD aims to increase the level of investor protection, transparency and compliance with the law in general. Depositaries do not only safeguard the fund's assets in this regard but also monitor the cash flow and ensure that the funds are administrated and operated in accordance with the law and in the interests of the investors. The importance of the role depositaries have come to play is also mirrored by the liability regime applicable in case of failure to comply with its obligations.[88]

C. Investment services governed by MiFID

1. General overview

27. MiFID was enacted to provide for a legal framework within which investments firms and banks can distribute investment products and offer investment services to individual clients. The financial services covered by MiFID entail a broad range of activities, including individual portfolio management, investment advice, and the execution of orders, underwriting and placing of financial instruments. MiFID therefore contains prudential and organizational rules, such as the requirement to obtain authorization from the competent authority, rules to ensure the sound and prudent management of authorized investment firms, compliance requirements, internal governance rules etc., but MiFID also includes rules directly and specifically aimed at increasing the level of investor protection. These rules have been placed under a separate heading in the directive and referred to as the conduct of business rules.

28. The conduct of business rules aim to ensure a high level of quality of investment services and therefore require the investment firms to act honestly, fairly and professionally in accordance with the best interests of its clients.[89] Investment firms are furthermore required to inform their clients fully and correctly, and provide them with suitable and appropriate advice, whilst also requiring the service providers to take the investor's level of expertise and knowledge into account.[90] More particularly,

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[85] Art. 23 AIFMD.

[86] Art. 6 (6) AIFMD. According to Article 6 (6) AIFMD certain provisions of MiFID (art. 2(2) and art. 12, 13 and 19) apply to the provision of the services referred to in Article 6 (4) AIFMD (individual portfolio management, investment advice etc.) by AIFMs. See *infra*, para. 31.

[87] Art. 21 (1) AIFMD: "For each AIF it manages, the AIFM shall ensure that a single depositary is appointed in accordance with this Article."

[88] See *infra*, para. 63.

[89] Art. 19 (1) MiFID.

[90] For a detailed overview: MOLONEY, *EC Securities Regulation*, 591; N. MOLONEY, 'Financial Market Regulation in the post Financial Services Action Plan Era', 55 *I.C.L.Q.*, 2006, nr. 4, 986 ff.; O.O. CHEREDNYCHENKO, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?', 33 *JCP*, 2010, No. 4, 406 ff. In addition to and before MiFID came into force however, private law already played a significant role in what was expected from financial services providers in terms of duties of care, information obligations and the like. In Italy for instance, hundreds of court decisions have been issued in the last two decades concerning breaches of information obligations, know your customer-rules and best execution duties imposed on financial intermediaries vis-à-vis their client-investors. These decisions are available at: www.ilcaso.it; see also: P. GIUDICI, 'Private law enforcement in a formalist legal environment: the Italian Sai-Fondiaria Case', 2008, ECGI - Law Working Paper No. 094/2008, available at SSRN: http://ssrn.com/abstract=1103985 4; and: A. PERRONE and S. VALENTE, 'Investor protection in Italy and the role of courts', 13 *EBOR* 2012, 31-44. In other Member States as well,

since MiFID recognizes that investors have different levels of expertise and knowledge on financial products leading to different, specific needs in terms of information and service, MiFID provides for regulation attuned to the specific needs of the types of investors, offering different levels of legal protection to them.[91] A concise overview of the client classification system and its implications for financial service providers is briefly presented below, prior to discussing the specific obligations imposed by MiFID.

29. Types of relations between investor and financial service provider. – MiFID distinguishes between three essentially different (contractual) relations between investors and service providers. The least far-reaching type is mere order execution in which the role of the investment firm is limited to that of an order executing intermediary. In case investment advice or portfolio management is provided, however, the obligations imposed on investment firms are more extensive and aimed at providing the (potential) client with a suitable investment strategy, information and advice.[92] The type of relation is thus of significant importance in determining the duties imposed on investment firms. This is however not the only element affecting the scope of the duties imposed on investment firms. The type of client in function of his needs and sophistication is also relevant in this regard.

30. Client classification system. – Investment service providers classify potential investors in mainly three categories of investors, being the retail client, the professional client, and a subcategory of the latter, the eligible counterparty.[93] The classification of an individual client is based on the information an investment service provider is required to obtain and relates to the experience and expertise a client has in the field of financial transactions and investments, the investment horizon, the resources available for the investment and the like. The obligation to gather relevant information about the client is also referred to as the 'know your customer' obligation. Whereas prior to MiFID, investment firms were required to take the type of client into account without a clear definition as to how investors were to be classified[94], MiFID provides for a rather strict classification system set out in its second Annex to the directive, leaving little room for investment firms to apply different standards. According to the MiFID client classification system, the retail client is the least sophisticated type of investor, requiring the highest degree of protection offered by MiFID. Professional clients by contrast are considered to be able to fend for themselves, at least to a certain extent, and thus require less formalities and rules to be taken into account.[95] Under MiFID, every investor is considered a retail investor, unless he qualifies as a professional client according to the listed criteria in annex II of the directive. Alternatively, when not automatically considered a professional client, a retail client may

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numerous cases relating to alleged breaches of rules of conduct could be observed, as illustrated *infra*: para. 100. See for the Netherlands: S.B. VAN BAALEN, *Zorgplichten in de effectenhandel*, Deventer, Kluwer, 2006, 137 ff. and references cited. With regard to Belgium, see for instance: M. KRUITHOF, 'A different approach to client protection', in S. GRUNDMANN and Y.M. ATAMER (eds.), *Financial services, financial crisis and general European contract law*, Alphen aan den Rijn, Wolters Kluwer, 2011, 154.

[91] See for a more extensive discussion on the client classification system: KRUITHOF, 'A different approach', 105-162; MOLONEY, *EC Securities Regulation*, 595.

[92] Compare: art. 19 (4) MiFID and art. 19 (5) MiFID.

[93] For an extensive discussion on the different types of investors under the MiFID client classification rules, consult: KRUITHOF, 'A different approach', 116-123.

[94] Council Directive 93/22/EEC of 10 May 1993 on Investment Services in the Securities Field, *OJ* L 197/58, (hereinafter: 'ISD').

[95] Art. 24 MiFID.

also request to be considered as professional clients and consciously opt out of the more protective retail client regime.[96]

2. Rules of conduct

31. Duty of loyalty. – The duty of loyalty is at the core of the conduct of business rules, requiring an investment firm to take the interest of the client-investors at heart.[97] Art. 19 (1) MiFID particularly obliges investment firms providing investment services and/or, where appropriate, ancillary services to clients, to act honestly, fairly and professionally in accordance with the best interests of its clients. Additionally, art. 19 (1) MiFID requires investment firms to comply with the more specific rules of conduct laid down in art. 19 (2) to (8) and art. 21 MiFID. In essence, these latter rules are specifications of the duty of loyalty as they mostly explain or clarify the implications of the duty of loyalty in detail. The best execution-duty for instance obliges investment firms to execute client orders in the client's best interest and specifies that this implies that criteria such as the price, the speed, likelihood of the execution and settlement of the order are taken into account when deciding on the terms that are most favorable to the client.[98] As a result, investment firms are required to establish and implement order execution policies in order to comply with the best execution-duty, containing information on the different venues where the investment firm executes its client orders and the factors affecting the choice of execution venue.[99] Other specific obligations concern information obligations, the Know you customer-obligation and obligations relating to the handling of conflicts of interest.

32. Disclosure obligations. – The provider of investment services is required to offer information in an appropriate and comprehensible manner to the potential client on proposed services and products. This includes information on the firm itself and its services[100], the risks involved[101], the policy followed in the execution of orders, the place where orders are executed, the costs related to the services[102], though only to the extent this is 'appropriate and proportionate' in the light of the type of client and the services he is interested in. The investment firm is also required to report *ex post* on the services provided and the costs incurred in order to enable the investor-client to evaluate and react in case of improper practices or violations.[103] Again, the aim of the disclosure obligations corresponds to the information paradigm, as illustrated in art. 19 (3) MiFID where it is stated that adequate information must be provided to investors "so that they are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis". The concrete information to be provided to the investors is described in detail in one of the implementing directives and includes information on the nature of the specific type of instrument concerned, as well as the risks particular to

[96] Annex II MiFID provides the possibility for investors to be treated as professional clients, provided that the criteria set out in the Annex II are met. See also: KRUITHOF, 'A different approach', 119.

[97] Art. 19 (1) MiFID.

[98] Art. 21 (1) MiFID. See for an extensive discussion of the scope of this obligation: CESR, 'Best Execution under MiFID', CESR/07-050b, available at: http://www.esma.europa.eu/system/files/07_050b.pdf. See also art. 44-46 Level Two MiFID Implementing Directive.

[99] Art. 21 (4) MiFID and art. 46 Level Two MiFID Implementing Directive.

[100] Art. 19 (3), first indent MiFID.

[101] Art. 19 (3), second indent MiFID

[102] Art. 19 (3), fourth indent MiFID. The information on the costs charged to the client are also intended to prevent churning practices. See on these obligations also: MOLONEY, 'Effective policy design', 394.

[103] Art. 19 (8) MiFID.

that specific type of instrument in sufficient detail.[104] According to these rules, this may include an explanation of leverage and its effects and the risk of losing the entire investment, whenever relevant in the light of the securities and the knowledge and status of the investor-client.[105] The information may be conveyed to the client in a standardized format.[106]

33. It is noted that MiFID does not apply to mediation activities involving (re)insurance contracts used for investment purposes.[107] These activities are regulated by the Directive on Insurance Mediation (IMD)[108], which imposes – amongst other requirements – information requirements on insurance intermediaries, yet the information duties imposed under the Directive on Insurance Mediation are considerably less extensive and substantial than those imposed on investment firms under MiFID. As will be clarified further below, the PRIPs-proposal aims to put an end to the differing information regimes by requiring standardized key investor information for a wide range of retail investment products, including insurance contracts with investment purposes.[109] Additionally, the revision of the IMD may also result in the inclusion of provisions similar to those contained in MiFID II.[110]

34. Know your customer (KYC). – In addition to providing information to retail clients, MiFID also obliges investment service providers to collect relevant information about clients ('know your customer'-obligation) in order to draw up investor profiles that allow investment firms to provide suitable or appropriate services and/or products.[111] The information to be gathered concerns the investor's financial background, investment objectives, experience and knowledge, and depends on the type of relationship. In case the client wishes to receive financial advice or conclude a contract concerning the management of an investment portfolio, the KYC-obligations are considerably more extensive and different in aim than the appropriateness test required in the context of the order execution services regulated by art. 19 (5) MiFID.[112]

[104] Art. 31 (1) and (2) Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, *OJ* L 241/26 (hereinafter: 'Level Two MiFID Implementing Directive'). For a complete overview of information to be provided to the investor-client: art. 29-33.

[105] Art. 31 (2) (a) Level Two MiFID Implementing Directive.

[106] Art. 19 (3) MiFID.

[107] Althoug the European Parliament suggested to extent the scope of some of the MiFID requirements to insurance undertakings and insurance intermediaries in the process of the MiFID review (MiFID II), this suggestion was rejected. In a recent letter published on 19 September 2013, the chairman of EIOPA (Gabriel Bernardino) expressed concern "about the potential for a lack of regulatory consistency and a detrimental impact on consumer protection to arise, were provisions on the sale of insurance investment products to be included under the scope of MiFID II." Rather than extending MiFID II to insurance products, the chairman recommends the inclusion of provisions similar to those contained in MiFID II in upon revision of the IMD (IMD II). See for this letter: https://eiopa.europa.eu/.

[108] Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation, *OJ* L 009/3.

[109] See *infra*, para. 38.

[110] See ftn. 107. See also : European Commission, Proposal for a Directive of the European Parliament and of the Council on insurance mediation (recast), COM(2012) 360 final, Strasbourg, 3 July 2012, available at http://eur-lex.europa.eu/.

[111] See also: M. STORCK, 'Les obligations d'information, de conseil, et de mis en garde des prestataires de services d'investissment', *Bull. Joly Bourse*, 2007, May-June312-322, §66; VAN BAALEN, *Zorgplichten*, 179 ff. Compare with the US suitability doctrine: N.S. POSER, 'Liability of broker-dealers for unsuitable recommendations to institutional investors', *B.Y.U. L. Rev.*, 2001, 1527 ff.

[112] Art. 19 (4) MiFID. See more extensively: VAN BAALEN, *Zorgplichten*, 184-190; KRUITHOF, 'A different approach', 130; MOLONEY, 'Effective policy design', 404.

35. Appropriateness – The appropriateness test is required investment firms provide services other than investment services and portfolio management (for instance in some cases of order execution) and implies the duty to ask information about the client regarding his knowledge and former experience in order to assess whether the service or product is appropriate for the client .[113] In case an investment firms concludes that the envisaged investment is not appropriate for the client, the investment firm is required to warn the client, which may be done in a standardized format. To the extent the firm is not provided with the information necessary to evaluate the appropriateness, it must warn the client that the appropriateness of the service or product cannot be assessed. In short, in the context of mere execution services, the client bears the responsibility for his investment decisions, whereas the investment firm should carry out a preliminary investigation as to whether the client is able of bearing the responsibility in terms of whether he has the necessary level of knowledge and experience. The appropriateness test does not apply to all types of execution orders, however. To the extent certain conditions are met (regarding the complexity of the instruments involved, the initiative taken by the potential client or client, ...), the service is labeled an 'execution only' service, which the investment service provider may execute without carrying out the aforementioned appropriateness test.[114]

36. Investment advice or portfolio management, suitability – In case of financial advice or portfolio management however, more detailed information is needed regarding the investment horizon, objectives, experience and expertise, willingness to take certain risks and the (potential) client's financial situation. Other than is the case in an order execution relation, financial advice and portfolio management imply the investment firm to advise on or determine the investment strategy, including a considerably larger responsibility for the services provider.[115] Information on the investment objectives are of considerable importance in this context, for example whether the investor-client intends to use the proceeds of the investment rather as (part of) a fixed income, a complementary income, mere speculation or the general accumulation of his assets without further specified goal. The information gathered on the objective plays an important role with regard to the investment horizon and willingness to take risks. To the extent the investment is meant to enable the investor-client to maintain his living standard (and potentially including the maintenance of his family) after retiring for instance, a more conservative type of investment will be recommended compared to an investor intending to take his chances with money not needed to provide for living expenses. If the investment firm has not been provided with the necessary information to assess the suitability of the product by the client, it should abstain from giving any advice or recommendations.[116]

37. Conflict of interests. – Other obligations are aimed at the handling of conflicts of interest, imposing rules on intermediaries to prevent the emergence of such conflicts, for instance by setting rules relating to Chinese walls and compliance requirements.[117] If a conflict of interest is to rise notwithstanding the aforementioned precautions, and it is made clear that it is the responsibility of the service provider to undertake all possible efforts to detect such conflicts, the provider is obliged to

[113] Art. 19 (5) MiFID. VAN BAALEN, *Zorgplichten*, 185 ff.; KRUITHOF, 'A different approach', 133; MOLONEY, *EC Securities Regulation*, 617.
[114] Art. 19 (6) MiFID.
[115] VAN BAALEN, *Zorgplichten*, 185; MOLONEY, *EC Securities Regulation*, 614; KRUITHOF, 'A different approach', 130.
[116] Art. 35 (5) Level Two MiFID Implementing Directive.
[117] For an extensive discussion, see: MOLONEY, *EC Securities Regulation*, 499 ff.

disclose the existence of a conflict of interest to the client.[118] The conflict of interest regulation applies invariably, regardless of the type of client in terms of the MiFID client classification system.[119]

D. The Packaged Retail Investment Products Regulation (PRIPs)

38. More recently, the Commission has initiated the drafting of yet another financial services law directive, being the Packaged Retail Investment Products Regulation (PRIPs).[120] PRIPs was initiated in the aftermath of the financial crisis and aims to provide for a more appropriate legal framework in which complex financial products can be sold to retail investors. With respect to the distribution of retail financial products, the Commission identified two key problems, being the asymmetries of information and the existence of conflicts of interests[121]. To address these problems, the Commission pursues the imposition of a minimal precontractual information obligation vis-à-vis the retail investors, the obligation to have a the advice and recommendations offered to the investors on written carriers, and the duty to take the specifics of the particular investor into account in advising him on financial products. Additionally, the Commission also intends to regulate potential conflicts of interests that may rise in advising potential clients and the practice of the inducements by suitability and appropriateness tests.

With regard to the disclosure obligations, it is worth noting that the PRIPs-proposal aims to standardize and harmonize key investor information to be provided to retail investors for a wide range of retail investment products regardless of their legal structure. Put differently, PRIPs is meant to apply horizontally to a variety of retail investment products with comparable commercial interest, regardless of whether the financial products have been structured as collective investment products to be distributed through UCITS, as retail structured products or as certain types of insurance contracts used for investment purposes. This information is to be conveyed to the retail investor in the form of the key information document ("KID") in a standardized manner. As it is aimed to address retail investors, the key information document should be kept short and concise, drafted in non-technical language, understandable by the average or typical retail investor, and separately readable as a standalone document so that investors are not required read other documents to be able to understand the key features of the investment product and take an informed investment decision.[122] It should also be drafted in a common format so that investors are able to easily compare between different investment products. The KID resembles (and was initially inspired on) the UCITS key investor information,

[118] Art. 13 and 18 MiFID.

[119] For an extensive discussion on the conflict of interest regulation: M. KRUITHOF, 'Conflicts of Interest in Institutional Asset Management: Is the EU Regulatory Approach Adequate?', L. THÉVENOZ and R. BAHAR, *Conflicts of interest: corporate governance and financial markets*, Alphen aan den Rijn, Kluwer, 2007, 277; PANASAR and BOECKMAN, *European Securities Law*, 81, para. 1.258 ff; MOLONEY, *EC Securities Regulation*, 499.

[120] European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012/0169, 352 final, Brussels 3 July 2012, available at http://eur-lex.europa.eu.

[121] Idem, 3.

[122] Rec. (16) of the draft Regulation on key information documents for investment products: "Key information documents are the foundation for investment decisions by retail investors."; to be consulted: European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012/0169, 352 final, Brussels 3 July 2012, available at http://eur-lex.europa.eu.

which will be replaced by the KID after a transitional period of five years following the future PRIPs entry into force.[123]

IV. Conclusion – The continued evolution of the investor protection legal framework: the information paradigm under pressure

39. It can be concluded that the provision of correct, timely and complete information is at the center of the EU investor protection system, regardless of whether it concerns issuer or financial services regulation.[124] Central to this model is the principle of investor autonomy, according to which the regulation aims to channel as much information as possible into the markets and to professional and retail market participants. Investors can also choose to consult professional investment service providers in order to receive information, advice or recommendations tailored to their individual profile and preferences, yet the final responsibility for the decisions made still lies with the investors. Investor autonomy is one of the cornerstones of investor protection measures underlying EU capital market law, provided that investors are offered easy access to all relevant information to make their decisions on an informed basis.[125]

40. As pointed out earlier, however, behavioral finance has demonstrated the limits of the rational investor model and the information paradigm, supporting the conclusion that investor rationality is bounded and causes investors to suffer from systemic biases and irrationalities. As the recent financial crisis demonstrated that even the most sophisticated investors failed to understand the risks involved in the instruments they traded in, the question has been asked whether and how the current regulatory model can be improved and adjusted to these insights. Not only the scholarly literature has started to ask these questions, legislators as well have shown interest and willingness to adjust policy and regulation to new insights.[126] The initiative undertaken by the former FSA (now FCA) and a study ordered by the European Commission are illustrative in this regard. Both documents discuss the behavioral biases to which financial consumers in retail markets are susceptible and how legal policy

[123] Art. 24 European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012/0169, 352 final, Brussels 3 July 2012, available at http://eur-lex.europa.eu.

[124] The importance attached to disclosure is not only visible in EU capital market law, but also characterizes accounting law and company law in general, as well as consumer law. For an overview of the role of information in EU company law (in a broad sense, i.e. including accounting and capital market law), consult: GRUNDMANN (ed.), *European Company Law. Organization, Finance and Capital Markets*, 166 ff. Based on his findings, the latter author concludes that "There is virtually no legislative measure in European company law which is not primarily about information" (p. 168). See also: VEIL, *Europäisches Kapitalmarktrecht*, 43 ff. On the predominant role of information obligations with regard to issuer regulation, see also: SCHAEKEN WILLEMAERS, *EU Issuer-Disclosure Regime*, 25 ff. For a discussion on the EU information obligations in the context of consumer law: A. NORDHAUSEN SCHOLES, 'Information Requirements', G. HOWELLS and R. SCHULZE, *Modernising and Harmonising Consumer Contract Law*, Munich, Sellier, 2009, 213; P. ROTT, 'Information obligations and withdrawal rights', C. TWIGG-FLESNER, *Cambridge Companion to European Union Private Law*, Cambridge, Cambridge University Press, 2010, 187. For a (critical) note in this regard: N. REICH, 'The Social, Political and Cultural Dimension of EU Private Law', R. SCHULZE and H. SCHULTE-NÖLKE, *European Private Law - Current status and perspectives*, Munich, Sellier, 2011, 60-61.

[125] In the same sense: KLÖHN, 'Preventing Excessive Retail Investor Trading', 437. The latter for instance points out that in case investors fail to provide the necessary information to conduct these tests, the investment firm is not bound to stop the client from trading, yet can suffice with a (standardized) warning in case of appropriateness, or refrain from providing advice in case of suitability (p. 446). Similar remarks are made in MOLONEY, *EC Securities Regulation*, 602 and 612 with regard to the regulatory approach underlying the disclosure obligations imposed by MiFID.

[126] KLÖHN, 'Preventing Excessive Retail Investor Trading', 454; L. ZINGALES, The costs and benefits of financial market regulation, 2004, ECGI Law Working Paper N° 21/2004, available at: www.ssnr.com/abstract=536682, 3.

can respond to these insights.[127] The FCA advances some preliminary ideas on how to implement these insights in their interventions, including requirements or rules on marketing materials for the promotion of financial products[128], controlling products and product distribution in terms of banning features or products, or set requirements to the distribution of these products.[129]

Overall, this new approach differs from the traditional emphasis on disclosures in various respects. First of all, this approach marks a shift from an investor-based approach to a consumer-based focus on regulation.[130] Whereas investors are traditionally associated with risk-taking, consumers on the other hand are rather associated with need for protective measures as end-users of products offered to satisfy consumer needs, marking a stronger inclination to consumer protection in the legal framework governing these transactions.[131] Secondly, different from the disclosures aimed to support the decision-making process (at the point of sale or close to that point), recent measures or proposed measures intervene earlier in the process to prevent certain products from being offered, regulate the marketing of the products or even consider approval procedures at the level of the distributors and banning certain products from distribution to retail investors.[132]

41. Product intervention on the EU-level. – The changing insights and their impact on regulation are also illustrated by legislative and regulatory initiatives installing product bans. For instance, the regulation establishing ESMA, the European Securities and Markets Authority, attributes ESMA the power to temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or the financial stability, provided that the conditions to do so are met.[133] The MiFIR-proposal illustrates how this power can be put to practice by proposing that ESMA may temporarily prohibit or restrict types of financial activity or practices or the marketing, distribution or sale of certain financial instruments or financial instruments.[134] Moreover, on the national level too regulators would be provided with a similar power, be it that the restrictions or prohibitions are not limited by temporary restrictions as is the case with ESMA.

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[127] ERTA, HUNT, ISCENKO and BRAMBLEY, 'Applying behavioural economics at the Financial Conduct Authority', 71p; and: CHATER, HUCK and INDERST, 'Consumer Decision-Making', 490p.

[128] Similar: CHATER, HUCK and INDERST, 'Consumer Decision-Making', 231, para. 354.

[129] ERTA, HUNT, ISCENKO and BRAMBLEY, 'Applying behavioural economics at the Financial Conduct Authority', 42 and 47.

[130] FSA, Discussion paper, 'Product Intervention', DP11/1, January 2011, available at: www.fsa.gov.uk, 11 ("The discussion in this paper relates to a broad range of financial products used by retail consumers"); CHATER, HUCK and INDERST, 'Consumer Decision-Making', 3 ff. stating that the purpose of the project was to study the decision-making process of consumers in the market for retail investment services, while the title as well refers to consumers. See on this topic also: N. MOLONEY, 'The investor model underlying the EU investor protection regime: Consumers or Investors', 13 *EBOR* 2012, iss. 2, 169 ff.

[131] According to MOLONEY, the shift from investor to consumer implies a shift in characterization since investors are associated with capital supply, willing to accept inherent investment risk and responsible for the implications of such activities (*caveat emptor*). Consumers on the other hand are associated with need for stronger protective rules and less with risk-taking, consuming products manufactured on the market rather than providing capital to the market (173-174). Summarized, MOLONEY asserts that the different characterizations invoke different connotations, including different needs in terms of protection and responsibility for risk taking. MOLONEY, 'Consumers or Investors', 169.

[132] These options are discussed in a discussion paper issued by the former FSA (now FCA) and discussed as potential future regulatory approaches: FSA, Discussion paper, 'Product Intervention', DP11/1, 43-61; ERTA, HUNT, ISCENKO and BRAMBLEY, 'Applying behavioural economics at the Financial Conduct Authority', 16. See on this topic also: T.M.J. MÖLLERS, 'Paradigmenwechsel durch MiFID II: divergierende Anlegerleitbilder und neue Instrumentarien wie Qualitätskontrolle und Verbote', 42 *ZGR* 2013, iss. 4, 437.

[133] Art. 9 (5) Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, *OJ* L 331/84.

[134] Art. 31 (1) (a) and (b) MiFIR-proposal. The conditions to be satisfied to exert these powers are listed in art. 31 (2) MiFIR. See in this regard also: MOLONEY, 'Consumers or Investors', 181.

42. Product intervention on the national level. – In addition to the evolutions taking place at the EU level, it should also be noted that national legislators and supervisors have already undertaken steps to exert a stricter control on the distribution of complex retail financial products. More particularly, as regulators felt that the (mis-)selling of complex and risky products to retail investors, saddling the latter with considerable losses when the crisis unfolded, measures were promulgated aimed at preventing these practices from recurring, including measures aimed at product control and intervention. For example, the Belgian supervisor, the Financial Services and Markets Authority ('FSMA'), introduced a voluntary moratorium to which the financial sector can sign up to commit themselves not to distribute structured products that are considered particularly complex to retail investors.[135] Denmark on the other hand responded to the mis-selling problems involving retail investors by introducing a labeling system for retail investment products, signaling its risk and complexity level (by traffic light codes) to investors.[136] Depending on the label, the products are particularly divided into three categories, each representing a level of risk and complexity.

Yet another example of increased product control is the Dutch product approval procedure and product review procedure that entered into force in 2013. According the Dutch law, banks, insurance companies and other offerors of financial products and parties that combine products to form a new product are now required to apply adequate product approval procedures to ensure that the client's interests are considered when designing and developing investment products (product approval procedure).[137] As a result, financial institutions have a duty of care to ensure that the relevant target group to whom the products will be marketed is clearly delineated, the purpose of the product vis-à-vis this group must be clarified, the product information must be fit for the target group.[138] To the extent these conditions are not met, the marketing of the product must be suspended. The Dutch Financial Market Authority ('*Autoriteit Financiële markten'*) is authorized to intervene in the process of product design to ensure compliance and prevent the commercialization of unsuitable products.[139] In a consultation note, the Belgian supervisor also discussed the introduction of rules on product design and product approval process with regard to structured products.[140]

43. Implications of product intervention. – As acknowledged in the FCA report, this kind of measures are far more intrusive and interventionist, and as such prone to criticism as being 'paternalistic' and contrarian to the investor autonomy model – which includes "the right to make a fool of yourself" as some have put it[141] – that has always been a pillar of the EU policies.[142] The

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[135] FSMA, Communication FSMA 2011_02 of 20/06/2011, 26 September 2011, available: www.fsma.be. See also: R. STEENNOT, 'De bescherming van de consument door de Autoriteit voor Financiële Diensten en Markten en het vrijwillig moratorium op de commercialisering van bijzonder ingewikkelde gestructureerde producten', *T.Verz.*, 2011, nr. 17, 115.

[136] Executive Order no. 345 of 15 April 2011 on Risk-Labeling of Investment Products, http://www.dfsa.dk.

[137] Art. 32 Besluit van 21 december 2012 tot wijziging van het Besluit Gedragstoezicht financiële ondernemingen Wft, het Besluit marktmisbruik Wft, het Besluit prudentiële regels Wft, alsmede enige andere besluiten op het terrein van de financiële markten (Wijzigingsbesluit financiële markten 2013), STB 2012 695 (entered into force on January 1st, 2013). Note however that the rules do not apply to investment firms and Undertakings for Collective Investments in Transferable Securities (UCITS) according to art. 32 (7) Wijzigingsbesluit financiële markten 2013. See extensively: B. BIERENS, 'Het productontwikkelingsproces voor financiële ondernemingen: meer veiligheid maar ook nieuwe valkuilen', D. BUSCH, C.M.J. KLAASSEN and T.M.C. ARONS, *Aansprakelijkheid in de financiële sector*, Deventer, Kluwer, 2013, 461.

[138] Art. 32 Wijzigingsbesluit financiële markten 2013.

[139] Note that the responsibility for the design of financial products is imposed on the financial institutions and not the supervisor.

[140] FSMA, Consulatienota, 12 August 2011, Consultatienota over de invoering van een reglementair kader voor de commercialisering van gestructureerde producten bij retailbeleggers, available at www.fsma.be.

[141] KLÖHN, 'Preventing Excessive Retail Investor Trading', 439.

developments with this alternative regulatory approach are still at its infancy, however, while behavioralism continues to develop with trial and error. Caution is thus warranted when attempting to implement these insights in regulation, especially with regard to potential legal implications this change of perspective may bring about. For instance, to the extent this line of thinking is converted into actual regulation and the current focus on information is reoriented towards product design and control, it will be interesting to see whether, and if so to what extent, the responsibility for (retail) inventors' investment decisions will be increasingly shifted towards investment firms (or even supervisors). As the implications on the level of civil liability in case of mis-selling are not illusionary in this scenario,[143] more research is needed considering both effectiveness and legal implications of the evolving regulatory approach to retail investor protection.

44. While legislators, supervisors and academics are contemplating the underlying investor protection model however, other insights have evolved as well. For instance, although the transposition of the European financial market directives into the national legal systems of the Member States has harmonized and modernized capital market law to a significant extent, there has been a growing awareness that the existence of mere legislation is insufficient to ensure effective investor protection.[144] As crucial is the actual enforcement of the rules, or as it is phrased in the current debate, to the extent there is a gap between the so-called 'law on the books' and 'law in action', the rules are bound to remain dead letter.[145] As a result, scholars in the fields of finance and financial law have turned their attention to the importance of enforcement as a prerequisite for a well developed capital market. The development of this broader and more substantial capital market regulation inevitably raises the question as to how this extensive body of rules is brought into practice. Indeed, notwithstanding the important degree of harmonization achieved over the last two decades, the actual establishment of a single market for financial services can only be realized on the condition that the created legal framework is effectively enforced.[146] In the next chapter, the enforcement, and particularly the private enforcement of EU rules is discussed.

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[142] SPINDLER, 'Behavioural Finance and Investor Protection Regulations', 327; KLÖHN, 'Preventing Excessive Retail Investor Trading', 448-450; see on this topic also: MOLONEY, *How to protect investors*, 46-47; G. SCHAEKEN WILLEMAERS, Product Intervention for the Protection of Retail Investors: A European Perspective, 2013, Risques, crise financière et gouvernance: colloque transatlantique, available at SSRN: http://ssrn.com/abstract=1989817; MÖLLERS, 'Paradigmenwechsel durch MiFID II', 437.

[143] See for instance a recent decision delivered by the German Supreme Court: BGH, 22 March 2011, XI ZR 33/10. See for an extensive comment from the perspective of investor protection and product intervention: J. BONAVITA, 'The regulation of 'speculative interest-rate bets' by the German Federal Court of Justice - new dimensions of market intervention hidden behind the old information model', 13 *EBOR* 2012, iss. 2, 271-280.

[144] S. KALLS, 'Recent developments in liability for nondisclosure of capital market information', 27 *Int'l Rev L & Econ*, 2007, 74 ff.

[145] The importance of enforcement has been brought under the pressing attention of economic and legal scholars in the field of financial markets by the LLSV research discussed below (see *infra*, para. 54). Numerous publications have stressed the importance of enforcement with regard to financial markets. See particularly in this regard: M. HUMPHERY-JENNER, 'Strong financial laws without strong enforcement: Is good law always better than no law?', 10 *J. Empirical Legal Stud.*, 2013, iss. 2, 288; and also in the US (legal) academic literature: B. BLACK, 'The Legal and Institutional Preconditions for Strong Securities Markets', 48 *UCLA L. Rev.*, 2001, 781-855; J. C. COFFEE, 'Law and the Market: The Impact of Enforcement', 156 *U. Pa. L. Rev.*, 2007, 229.; A. CARVAJAL and J. ELLIOTT, 'Strengths and Weaknesses in Securities Market Regulation: A Global Analysis', 2007, IMF Working Paper WP/07/259, available at: http://www.imf.org p. 19 ff. See on the topic of law enforcement in a more general and abstract manner also: K. PISTOR and C. XU, 'Incomplete law', 35 *N.Y.U. J. Int'l L. & Pol.*, 2003, 934. In the EU context, see also on this topic: C. MAK, 'Rights and Remedies - Article 47 EUCFR and Effective Remedies in European Private Law Matters', 2012, available at SSRN: http://ssrn.com/abstract=2126551, 20 p.

[146] For instance: MOLONEY, *How to protect investors*, 426; E. FERRAN, 'Capital market competitiveness and enforcement', 2008, available at: http://papers.ssrn.com/ 10p.; COFFEE, 'Law and the Market', 229; N. REICH, 'The interrelation between rights and duties in EU law: Reflections on the state of liability law in the multilevel governance system of the Union: Is

there need for a more coherent approach in European Private Law?', P. EECKHOUT and T. TRIDIMAS, *Yearbook of European Law*, vol. 29, Oxford, OUP, 2010, 120.

CHAPTER II. PRIVATE ENFORCEMENT OF EU CAPITAL MARKET LAW – EUROPEAN LEGAL FRAMEWORK

I. Goals of enforcement: deterrence and compensation

45. As set out in the previous chapter, EU capital market law has been promulgated at considerable pace, deepening and widening the existing legal frameworks in the Member States. The enactment of legislation as such has not proven sufficient to secure a solid financial legal system, however. Only by means of an adequate law enforcement system that organizes supervision of the markets and its participants, that intervenes and sanctions when infringements occur, compliance with and effectiveness of the legal framework is ensured.[147] Enforcement actions traditionally focus on creating a deterrent effect aimed at discouraging wrongdoers from law violation (the fear factor) on the one hand, and compensating the victims for the harm inflicted on them as a result of the wrong on the other hand. Moreover, besides remedying the loss the victim suffered, compensation in itself may also have a deterrent effect as it imposes the costs of the legal remedy on the wrongdoer. The prospect of having to cover for making the victim whole, added with enforcement costs (litigation costs for instance) or fines, is likely to have a deterrent effect on potential wrongdoers.[148] As a result, market participants are incited to comply with the rules while feeling protected from potential harm that may be inflicted by another party's wrongdoing. Law enforcement actions – regardless of whether it concerns private or public enforcement actions – are hence predominantly aimed at deterrence and compensation in order to ensure the effectiveness of and confidence in the legal system.

With regard to capital market law, law enforcement is particularly aimed at ensuring the orderly and efficient operation of markets as it is widely believed that to the extent enforcement of regulation is sufficiently intense, investors and other market participants will display more trust and confidence in the financial system and find themselves more willing to invest and interact.[149] The attractiveness of a financial market is translated into a lower cost of capital, which appeals to issuers and adds to the liquidity and robustness of the market.[150]

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[147] PISTOR and XU, 'Incomplete law', 934; J.M. GLOVER, 'The structural role of private enforcement mechanisms in public law', 53 *Wm. & Mary L. Rev.*, 2012, iss. 4, 1142 ("[…] our system of regulation is only as good as the enforcement mechanisms underlying it.").

[148] A. ROSE, 'Reforming Securities Litigation Reform: Restructuring the Relationship between Public and Private Enforcement of Rule 10B-5', 108 *Colum. L. Rev.*, 2008, 1325; N. SPITZ, *La réparation des préjudices boursiers*, Paris, Revue Banque, 2010, 87, para. 131; W. WURMNEST, 'Damages', in J. BASEDOW, K.J. HOPT and R. ZIMMERMANN (eds.), *The Max Planck encyclopedia of European private law*, Vol. I, Oxford, Oxford University Press, 2012, 445.

[149] MOLONEY, *How to protect investors*, 426 and references cited; ZINGALES, 'The Future of Securities Regulation', 397. In more general terms, pointing out that the role of civil liability has expanded to correct market failures, and particularly asymmetric information in financial markets and professional malpractice, and performs deterrent and compensatory functions: F. CAFAGGI, 'A coordinated approach to regulation and civil liability in European law: rethinking institutional complementarities', in F. CAFAGGI (ed.), *Institutional Framework of European Private law*, New York, Oxford University Press, 2006, 195.

[150] COFFEE, 'Law and the Market', 229, asserting that low levels of enforcement on securities market may result in hidden costs for society as the costs of capital is raised when enforcement is lax (p.311). See also: BUTTIGIEG, 'An Evaluation of the Theories and Objectives of Financial Regulation Post the 2007-2009 Financial Crisis: A European Perspective', also available at SSRN: http://ssrn.com/abstract=2121334, p. 27 ff.; MOLONEY, *How to protect investors*, 426. See in this regard also (empirical): H.B. CHRISTENSEN, L. HAIL and C. LEUZ, 'Capital-Market Effects of Securities Regulation: Hysteresis, Implementation, and Enforcement', 2011, Chicago Booth Research Paper No. 12-04, available at SSRN: http://ssrn.com/abstract=1745105, 7. The authors analyze whether the enactment, transposition and enforcement of EU market directives (the (former) Market Abuse Directive and the Transparency Directive in particular) have generated

46. The role law enforcement may play with regard to the strength of capital markets has received considerable interest in recent academic literature, yet no clear answers exists as to how an enforcement system should be organized to achieve these goals as effectively and efficiently as possible.[151] In Europe, deterrence has traditionally been considered the prerogative of public enforcement, while compensation for injuries suffered by victims is primarily associated with private enforcement and, as such, the first and foremost task of the laws of damages in European legal systems.[152] In the US on the other hand, private enforcement seems to be playing a (far) more important role with regard to deterrence, whereas public enforcement has taken on compensatory tasks in some areas of law as well, notably with regard to secondary market misreporting. [153] Illustrative of the differing views on the role private enforcement can fulfill with regard to deterrence is the notable absence of punitive damages in European countries for instance, while in the US punitive damages are longstanding.[154] Punitive damages are damages awarded to victims of infringements not to compensate for the injury, but to punish for the wrong committed and deter wrongdoing altogether. Whereas punitive damages are often applied to ensure deterrence and discourage certain behavior in US courts, other (and especially civil law) countries adhere rather strictly to the principle of full indemnification

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beneficial capital market effects and report that improving securities regulation can lead to substantial capital market effects, yet this effect seems limited to countries with high-quality prior regulation and ability and willingness to implement and enforce the regulation (p.3). Similar beneficial market effects (and a lower cost of capital in particular) were observed with regard to the existence and enforcement of insider trading regulation by U. BHATTACHARYA and H. DAOUK, 'The World Price of Insider Trading', 57 *Journ. Fin.*, 2002, 75. Other, earlier studies however have doubted the preposition that securities regulation produce beneficial capital market effects such as market liquidity. An overview of these studies is presented: CHRISTENSEN, HAIL and LEUZ, 'Capital-Market Effects of Securities Regulation', 6.

[151] Carrying out research on the beneficial effects of private and public enforcement in terms of financial market development, ROE & JACKSON conclude: that "[…] we do not see the data as telling us that public enforcement is more important than private enforcement.[…] Causal channels have not yet been shown for either public or private enforcement. […] Further improving how we measure enforcement may yield a better understanding of which outcomes public enforcement most affects, which ones private enforcement influences, which channels for each are vital, and how the two main enforcement mechanisms interact." H.E. JACKSON and M. ROE, 'Public and Private Enforcement of Securities Laws: Resource-Based Evidence', vol. 93 *JFE*, 2009, iss. 2, (207) 237.

[152] WURMNEST, 'Damages', 445. WURMNEST asserts that compensation is the primary goal of damages, yet in some legal systems such as Austria, France, England and Germany, a preventive function is attributed to the law of damages too. See in this regard also: CAFAGGI, 'A coordinated approach', 211; S. MARTENS and R. ZIMMERMAN in B. WINIGER, H. KOZIOL and R. ZIMMERMAN (eds.), *Digest of European Tort law*, Vol. 2: Essential cases on Damage, Berlin, Boston, De Gruyter, 2011, 18, para. 4 (Germany); H. BOCKEN and I. BOONE, *Inleiding tot het schadevergoedingsrecht*, Brugge, die Keure, 2011, 31, para. 37 (Belgium, France); H. KOZIOL, *Basic questions of tort law from a Germanic perspective*, Wien, Jan Sramek Verlag, 2012, 75.

[153] Reference can be made to the US Federal Account for Investor Restitution Funds (Fair Funds) introduced by section 308 of the US Sarbanes-Oxley Act in 2002, allowing the SEC to use the proceeds of public enforcement actions to be used to compensate victims of the violation. Another example consists of the UK restitution orders regulated by s. 382 and 383 FSMA. Based on these provisions, the UK Financial Conduct Authority (FCA) may demand that the wrongdoer offers restitution to the victims of violations of the reporting requirements (s.382 FSMA) or market abuse regulation (s.383 FSMA). These compensatory tasks of financial supervisors are discussed in one of the following chapters.

[154] See for instance the case in which an Alabama court awarded punitive damages to one of the parties, which the Italian courts considered unenforceable and saw their decision confirmed by the Italian Supreme Court. (Corte Suprema di Cassazione, 17 January 2007, no. 1183, *Foro italiano*, 2007, 1461. For a more extensive discussion of the case, consult: A.P. SCARSO, 'Punitive damages in Italy', H. KOZIOL, *Punitive Damages: Common Law and Civil Law Perspectives*, vol. 25, Wien, Springer, 2009, 106-107, para. 11-14. For an overview see also: H. KOZIOL, 'Punitive damages: admission into the seventh legal heaven or eternal damnation?', H. KOZIOL, *Punitive Damages: Common Law and Civil Law Perspectives*, Tort and Insurance Law Yearbook, Volume 25, Wien, Springer, 2009, 275-308; as well as the individual country reports in the book. In the same sense, see: U. MAGNUS (ed.), *Unification of Tort Law: Damages*, The Hague, Kluwer, 2001, 185. For a comparative point of view: WURMNEST, 'Damages', 445-446; and: G. WAGNER, 'Punitive Damages', in J. BASEDOW, K.J. HOPT and R. ZIMMERMANN, *The Max Planck encyclopedia of European private law*, Vol. II, Oxford, Oxford University Press, 2012, 1403-1406; S. MARTENS and R. ZIMMERMAN in WINIGER, KOZIOL and ZIMMERMAN (eds.), *Digest of European Tort law*, 18-19, para. 4 (Germany). Another example is the role played by the so-called private attorney generals in the US, who are private parties bringing claims that are considered in the public interest. See in this regard for instance: GLOVER, 'The structural role of private enforcement mechanisms in public law', 1137; see on the private attorney general (in the context of competition law): K. ROACH and M.J. TREBILCOCK, 'Private enforcement of competition laws', 34 *Osgoode Hall L.J.*, 1996, no. 3, 481.

that implies that victims should be awarded damages to remedy their injury, without being under- or overcompensated.[155] Although this thesis does not aim to elaborate the subject of optimal enforcement design in detail, it is contended in the final chapter of this thesis that the design of enforcement systems may notably impact its effectiveness.[156] The implications of using public and/or private enforcement actions is therefore concisely discussed and situated in the influential 'law matters'-literature that put the private/public enforcement-debate in the limelight and spurred the debate on the role of private enforcement of securities laws in the US and beyond.

II. Enforcement regimes: the public v. private enforcement debate

A. Overview: legal theory

47. The pros and cons of private and public enforcement have been the subject of longstanding debate in (mostly US) law and economics literature.[157] Overall, the law and economics literature has clearly established that the main differences between private and public enforcement generally relate to different incentives, the range of remedies or sanctions available, the role of information and the means to obtain information.[158] Both private and public enforcement techniques have drawbacks and advantages when considering these differences in more detail, yet the impact on the effectiveness of the enforcement system generally depends on a multitude of factors. The next paragraphs briefly discuss several of the factors that may impact the effectiveness of private enforcement compared to public enforcement mechanisms.

48. **Sanctions**. – It is generally accepted in the law and economics literature that sanctions should be set at the optimal level, which implies that sanctions should be high enough to deter the wrongdoer from violating the law, yet not too high as over-deterrence is undesirable too.[159] The optimal level is reached when the sanction internalizes all costs of the harm done to society as a whole and the costs of wrongdoing exceed the gains from the perspective of the wrongdoer.[160] Private enforcement does not always succeed in setting sanctions at an optimal level as only harm done to those individuals who

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155 See for instance in France the principle of '*réparation intégrale'*: G. VINEY and P. JOURDAIN, *Traité de droit civil. Les conditions de la responsabilité*, Paris, L.G.D.J., 1998, 452, para. 172; Belgium: J. RONSE, *Schade en schadeloosstelling*, Gent, Story Scientia, 1988, 213, para. 282; D. DE CALLATAŸ and N. ESTIENNE, *La responsabilité civile: chronique de jurisprudence 1996-2007*, Volume 2: le dommage, Brussel, Larcier, 2009 57. The Netherlands: J. SPIER, *Verbintenissen uit de wet en schadevergoeding*, Deventer, Kluwer, 1997 169, para 196; Germany: §249 BGB is based on the principle of complete reparation ('*Totalreparation'*) S. MARTENS and R. ZIMMERMAN in WINIGER, KOZIOL and ZIMMERMAN (eds.), *Digest of European Tort law*, 17-18; the principle of full compensation (in the context of contractual damages) is also mentioned in art. 9:502 PECL.

156 See *infra:* Part III, Chapter II.

157 A seminal publication by BECKER and STIGLER launched the debate by asserting that private enforcement could be as efficient as public enforcement when organized in a system that awarded damages to the private prosecuting party when the party charged with the claims was effectively considered liable in court. See in this regard: G. BECKER AND G. STIGLER, 'Law Enforcement, Malfeasance, and Compensation of Enforcers', 3 *J. Legal Stud.*, 1974, 1-18. LANDES and POSNER challenged the theory on the efficiency of private enforcement however, asserting that the system proposed by BECKER and STIGLER would result in over-enforcement every time when the fine would exceed the social costs of the wrongful behavior (e.g. whenever the chance of being detected is low, a higher fine may be imposed in order to deter potential wrongdoers). See in this regard: W.M. LANDES and R.A. POSNER, 'The Private Enforcement of Law', 4 *J. Legal Stud.*, 1975, 1. POLINSKY added that whenever the enforcement costs exceed the fine, no enforcement would be undertaken by private actors however, as there is no benefit to be gained by the private actors in those cases. See: A.M. POLINSKY, 'Private versus Public Enforcement of Fines', 9 *J. Legal Stud.*, 1980, no. 1, 105. On the structure of law enforcement see also: S. SHAVELL, *Foundations of economic analysis of law*, Cambridge, Belknap Press of Harvard University Press, 2004, 571, ff.

158 Idem.

159 SHAVELL, *Foundations*, 571, ff.; G.J. STIGLER, The Optimum Enforcement of Laws, 78 *J. Polit. Econ.,* 526.

160 Idem. See also: R.A. POSNER, *Economic Analysis of Law*, Aspen, New York, 2007, 662 ff.

decide to come forward and file claim is taken into account to determine the remedy.[161] Furthermore, private parties may also decide to settle, regardless of whether a settlement is beneficial or desirable in terms of deterrence and public interest.[162] As a result, it has been asserted that private enforcement may result in over- or under-deterrence when the amount of compensation is too low to deter, or too high when the monetary compensation awarded to the victims exceeds the level of social harm.[163] Public enforcers on the other hand can impose fines that can be fixed at a level considered adequate in terms of deterrence, reasonableness and proportionality. Secondly, comparing the range of sanctions or remedies available to both types of enforcers, it seems clear that public enforcers have a wider range of sanctions available, such as cease and desist orders, fines, the withdrawal of permits or licenses or even imprisonment.[164] Public enforcement thus allows for more tailored sanctioning mechanisms, adjusted to the degree of deterrence that may be considered needed, whereas private enforcement generally grants relief – often monetary compensation – dependent on the level of harm suffered, regardless of its deterrent effect.

49. Detection and information advantages. – With regard to detecting of the wrongdoing and gathering relevant information, the analysis is more complicated and depends on the type of information needed, the question whether the identity of the wrongdoer is known or not, etc. For instance, as public agencies have means and/or expertise at their disposal to enforce the law that private parties have not, public enforcement may be better placed in some circumstances to enforce the law. Public enforcers may for example have investigative powers at their disposal useful to track and identify anonymous violators, while they may also develop specialized knowledge and methods (e.g. specialized databanks) that private parties lack.[165] In the context of industry practices, however, it has been argued that private actors familiar with the industry may be better placed and able to enforce at considerable lower costs as they may have the expertise, information and knowledge necessary to enforce the claim.[166] Furthermore, when the wrong inflicted harm on a victim while the identity of the wrongdoer is known, private enforcement may offer an advantage over public enforcement as the costs of detection may be significantly lower, while victims of wrongdoing may also have an advantage in terms of availability of information and evidence because of their direct involvement.[167] Centralized public enforcers on the other hand may have to set up systems or notification procedures in order to find out whether wrongdoing occurred.

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[161] Idem.

[162] W.P.J. WILS, 'Should Private Antitrust Enforcement Be Encouraged in Europe?', 26 *World Competition: Law and Economics Review* 2003, iss. 3, 481; S.E. KESKE, *Group litigation in European competition law*, 21.

[163] POSNER, *Economic Analysis of Law*, 660.

[164] R. VAN DEN BERGH, 'Private enforcement of European competition law and the persisting collective action problem', 20 *MJ* 2013, iss. 1, 1, 6.

[165] S.E. KESKE, *Group litigation in European competition law*, Antwerp, Portland, Intersentia, 2010, 18.

[166] See in this regard for instance: M. STEPHENSON, 'Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies', 91 *Va. L. Rev.*, 2005, 127.

[167] SHAVELL, *Foundations*, 578-581. STEPHENSON, 'Public Regulation of Private Enforcement', 108; ROACH and TREBILCOCK, 'Private enforcement of competition laws', 472 and 480; L. KLÖHN, 'Private versus public enforcement of laws – a Law & Economics perspective', 2011, München,188; GLOVER, 'The structural role of private enforcement mechanisms in public law', 1154. This advantage is erased when the victim is unknown however (KLÖHN, 'Private versus public', 8); HUGHES, 'Equity Compensation', 1061; JACKSON and ROE, 'Public and Private Enforcement', 208. There is equally no informational or evidential advantage in case it concerns illegal cartels violating competition law or insider trading infringing securities laws, which are generally not noticed by private consumers or investors. See for a similar remark with regard to cartels and competition law: VAN DEN BERGH, 'Private enforcement of European competition law and the persisting collective action problem', 16.

Considering this argument in the context of deficient financial services, for example, an individual aggrieved investor is likely the first to note that an asset manager did not comply with his mandate and invested the client's funds in an undiversified or otherwise too risky manner, contrary to the contractual agreements in that regard. With regard to insider trading and market manipulation on the other hand, JACKSON and ROE observe that detection of these forms of misconduct requires centralized oversight, while ROSE asserts that the public enforcer is in a better position to detect wrongdoing in the context of mandatory issuer disclosure regimes too since it is the latter who centralizes and reviews the disclosures.[168] ROSE supports this view with empirical research indicating that private securities litigation plays a very modest role in detecting wrongs of this kind in the US.[169]

50. Incentives, staffing and resources. – Victims entitled to compensation clearly have an incentive to come forward and enforce the law.[170] With regard to public enforcement on the other hand, it has been contended that public enforcers have different incentives and priorities since they protect the general interest, as will also be illustrated in the last chapter of this thesis.[171] Furthermore, it has also been asserted that public service employees may have lower personal incentives to enforce certain cases, precisely because they do not gain direct personal financial benefits from their enforcement actions.[172] In some cases, differing incentives may also be caused by regulatory capture preventing the agency from acting when it is considered in the public interest to do so (for instance because of lobbying or political pressure).[173] Misalignment between individual, private incentives and public interests may also occur in the context of private enforcement, however, and cause the emergence of collective action problems and free rider effects for example.[174] Moreover, in case of victimless wrongdoing, i.e. wrongdoing that causes negative externalities but does not affect an

[168] JACKSON and ROE, 'Public and Private Enforcement', 209 (JACKSON and ROE note that even though private mechanisms could probably develop reliable disclosure and policing, they apparently have not done so in the US – p.210); ROSE, 'Reforming Securities Litigation Reform', 1344. See in this regard also: F. FERRARINI and G. GIUDICI, 'Financial Scandals and the Role of Private Enforcement: The Parmalat Case', in J. ARMOUR and J.A. MCCAHERY, *After Enron: Improving Corporate Law And Modernising Securities Regulation in Europe And the US*, Oxford, Hart Publishers, 2006, 195.

[169] ROSE, 'Reforming Securities Litigation Reform', 1344.

[170] SHAVELL, *Foundations*, 579; ROACH and TREBILCOCK, 'Private enforcement of competition laws', 480; on the profit-driven motivations of private parties in the context of US securities law enforcement: ROSE, 'Reforming Securities Litigation Reform', 1338; J.C. COFFEE, 'Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law through Class and Derivative Actions', 86 *Colum. L. Rev.*, 1986, 669; FERRARINI and GIUDICI, 'Financial Scandals', 196. In the context of competition law, see: S.E. KESKE, *Group litigation in European competition law*, 18.

[171] See *infra*, Part III, Chapter II, para. 534 ff.

[172] KLÖHN, 'Private versus public', 189-190; STEPHENSON, 'Public Regulation of Private Enforcement', 110; JACKSON and ROE, 'Public and Private Enforcement', 208; BURBANK, FARHANG and KRITZER, 'Private Enforcement of Statutory and Administrative Law in the United States (and Other Common Law Countries)', 34. This is countered in case public officials are motivated by ideological considerations, career goals, etc. See in this regard: SPITZ, *La réparation*, 95, para. 147.

[173] Specifically with regard to securities law, the SEC stated that "[p]rivate enforcement is a necessary supplement to the work that the SEC does. It is also a safety valve against the potential capture of the agency by industry." Cited by: S. LABATON, 'Businesses seek new protection on legal front', *N.Y. Times*, 29 october 2006, in which an SEC commissioner is cited. The article and citation are also mentioned in: GLOVER, 'The structural role of private enforcement mechanisms in public law', 1159, with reference in ftn. 94. See in this regard also: LANDES and POSNER, 'The Private Enforcement of Law', 41, presenting some examples in tax and antitrust law; ROACH and TREBILCOCK, 'Private enforcement of competition laws', 475 and 482; STEPHENSON, 'Public Regulation of Private Enforcement', 110; GLOVER, 'The structural role of private enforcement mechanisms in public law', 1155; POSNER, *Economic Analysis of Law*, 660-661.

[174] See for an example of free rider effects and collective actions problems in the context of derivative shareholder claims: C. GERNER-BEUERLE, PH. PAECH and E.-PH. SCHUSTER, Study on Directors' Duties and Liability, prepared for the European Commission DG Markt, April 2013, available at: http://ec.europa.eu/, xiii, observing that "enforcement of the company's claims through shareholders by means of a derivative action faces a collective action problem: the costs are borne by the shareholders who bring the action, while the passive shareholders benefit from the claimant's efforts." Similar, but in the context of private enforcement of antitrust: VAN DEN BERGH, 'Private enforcement of European competition law and the persisting collective action problem', 14. With regard to securities law enforcement: JACKSON and ROE, 'Public and Private Enforcement', 208.

identifiable victim, no private enforcement at all would take place, unless some compensation other than an injury-related compensation would be made available.[175]

51. With regard to the need for resources to enforce the law, it is noted that private enforcement can add to the resources spent on enforcement, mitigating concerns relating to the limited budget of public prosecutors. More particularly, since public resources and staffing is limited, public enforcers are generally forced to set priorities and choose to enforce those cases with the greatest impact, allowing minor wrongdoing to be left unpunished.[176] Hence, adding private enforcement as a complement to the system may contribute to the overall effectiveness of the system and allow public prosecutors to focus on those violations that do not provide sufficient incentives or cause other problems for private litigants to prosecute.[177] Finally, private enforcement may also contribute to the development of legal theory as the case law it generates may offer clarification on the interpretation of the law and occasionally brings forth refinements and novel, innovative theories stimulating the sophistication of the law.[178] As such, private litigation generates a public good in the form of legal innovation and legal certainty.

52. In general, findings that both public and private enforcement mechanisms have particular advantages and drawbacks led scholars to believe that the best results in terms of law enforcement may be reached if private and public law enforcement mechanisms are designed to complement each other, rather than being considered as substitutes.[179] Yet drawing on examples and observations in the (mostly US) scholarly literature, it is clear that the effectiveness and efficiency of both systems should be considered in the light of the specific regulation it aims to enforce, as well as the complexity of the various components of an enforcement model, including the procedural and substantive rules governing the procedures and sanctioning regimes.[180] From this perspective, it is especially

[175] As suggested in the model advanced by BECKER and STIGLER: BECKER and STIGLER, 'Law Enforcement, Malfeasance, and Compensation of Enforcers', 1.

[176] STEPHENSON, 'Public Regulation of Private Enforcement', 107; GLOVER, 'The structural role of private enforcement mechanisms in public law', 1154 and 1160. Particularly with regard to securities fraud enforcement: J.T. HUGHES, 'Equity Compensation and Informant Bounties: How Tying the Latter to the Former May Finally Alleviate the Securities Fraud Predicament in America', 82 *S. Cal. L. Rev.*, 2009, 1061; POSNER, *Economic Analysis of Law*, 662.

[177] STEPHENSON, 'Public Regulation of Private Enforcement', 107. Particularly with regard to securities fraud enforcement: HUGHES, 'Equity Compensation', 1061; FERRARINI and GIUDICI, 'Financial Scandals', 195-196.

[178] ROACH and TREBILCOCK, 'Private enforcement of competition laws', 481. STEPHENSON, 'Public Regulation of Private Enforcement', 112. Opponents of this view however contend that courts produce confusing and contradictory judgments that confound legal doctrine. See in this regard: S. B. BURBANK, S. FARHANG and H.M. KRITZER, 'Private Enforcement of Statutory and Administrative Law in the United States (and Other Common Law Countries)', 2011, U of Penn Law School, Public Law Research Paper No. 11-08, available at SSRN: http://ssrn.com/abstract=1781047, 41.

[179] With regard to consumer law, see for instance: K.J. CSERES, 'Consumer Protection in the European Union', in R.J. VAN DEN BERGH and A.M. PACCES (eds.), *Regulation and economics*, Cheltenham, Edward Elgar, 2012, 194: "With regard to entrusting enforcement to public bodies or private organizations, the question is not so much an "either-or" but rather what is the most effective allocation of enforcement between public law and private law techniques and how to achieve an optimal combination between these two techniques so that they can effectively complement each other". Similar with regard to securities law: FERRAN, 'US-style investor suits', 341-342. A lively discussion on private and public enforcement is also being held in the context of antitrust law. See for instance (amongst many publications on the topic): S.E. KESKE, *Group litigation in European competition law*, 18ff; W.P.J. WILS, 'Should Private Antitrust Enforcement Be Encouraged in Europe?', 473; J.P. DAVIS and R.H. LANDE, 'Defying Conventional Wisdom: The Case for Private Antitrust Enforcement', *Georgia Law Review* (forthcoming) also available at SSRN: http://ssrn.com/abstract=221705, 53.

[180] GLOVER, 'The structural role of private enforcement mechanisms in public law', 1142 and references cited (ftn. 10 in particular); STEPHENSON, 'Public Regulation of Private Enforcement', 121; ROSE, 'Reforming Securities Litigation Reform', 1331 and references cited in ftn. 136. ROSE points out that over-deterrence may cause issuers to take excessive precautions to prevent liability from occurring, may take a reluctant stance towards disclosing information for fear of being held liable if the information should turn out too premature or incorrect, with the result that the overlarge threat of litigation becomes harmful to society (p. 1333).

worthwhile to discuss the highly influential research on capital market law enforcement conducted by LA PORTA, LOPEZ-DE-SILANES, SCHLEIFER and VISHNY ('LLSV') and the responses and developments this particular strand of literature has elicited.

B. The law matters-approach

53. The LLSV private enforcement primacy. – The work of academics such as LA PORTA, LOPEZ-DE-SILANES, SCHLEIFER and VISHNY ('LLSV')[181] developed into the leading argument in favor of the enhancement of private enforcement mechanisms with regard to securities laws.[182] Summarized, the research of these authors focused on the existence and extent of the correlation between on the one hand certain indices that measured the power of private market actors, and on the other hand, stock market development.[183] The research contended that those countries that stimulated their financial markets through the development of private enforcement mechanisms for shareholders and investors had been more successful in constructing solid (or more specifically, deep and liquid) capital markets.[184] Public enforcement on the other hand was not found to affect the strength of a market in a similar manner.[185] According to the LLSV-research, these findings offer a valid explanation as to why common law countries – found to have stronger enforcement mechanisms aimed at the protection of private property rights of investors and shareholders – were more successful in terms of establishing well developed stock markets, as opposed to civil law countries, which were found to focus on public enforcement instead.[186] Hence, LLSV asserts that civil law countries failed to produce equally strong financial markets because they put their trust in active governmental bodies carrying out supervisory and monitoring tasks rather than private enforcement mechanisms.

54. Impact and criticism. – The LLSV-research made a large scholarly impact, laying the basis for further academic research in both the finance and legal literature, and had equally important influence on the policy level, including Europe.[187] Notwithstanding the undisputable resonance and

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[181] RAFAEL LA PORTA, FLORENCIO LOPEZ-DE-SILANES and ANDREI SCHLEIFER are the core authors of what is referred to as the LLSV stream of literature, and has by times also included ROBERT VISHNY. Other authors that have contributed in the stream of papers published on the topic by the three core authors are (amongst others) SIMON DJANKOV, ED GLAESSER, and DANIEL WOLFENZON.

[182] R. LA PORTA, F. LOPEZ-DE-SILANES and A. SCHLEIFER, 'What Works in Securities Laws?', 61 *Journ. Fin.*, 2006, 1-32. This research particularly examined how IPO's in 49 countries are regulated and how these regulatory methods impact the overall financial growth or development of the related financial market. The LLSV research was not limited to securities regulation; other fields of law and their relation to the financial development of a country were researched as well. See for instance: R. LA PORTA, F. LOPEZ-DE-SILANES and A. SCHLEIFER, 'Law and Finance', 106 *J. Polit. Econ.*, 1998, 1113-1155; R. LA PORTA, F. LOPEZ-DE-SILANES, A. SCHLEIFER and R. VISHNY, 'Legal Determinants of External Finance', 52 *Journ. Fin.*, 1997, 1131-1150; A. SCHLEIFER and D. WOLFENZON, 'Investor Protection and Equity Markets', 66 *JFE*, 2002, no. 1 3-27; explaining the (positive) correlation between shareholder protective mechanisms and stock market development: S. DJANKOV, R. LA PORTA, F. LOPEZ-DE-SILANES and A. SCHLEIFER, 'The Law and Economics of Self-Dealing', 88 *JFE*, 2008, 430-465. For a comprehensive and clear overview of the content and impact of the method developed and the research published by LLSV, consult: M.M. SIEMS and S. DEAKIN, 'Comparative Law and Finance: Past, Present, and Future Research', 166 *JITE*, 2010, 122; A. SCHLEIFER, 'Understanding Regulation', 11 *European Financial Management*, 2005, no. 4 439-451.

[183] Factors measured to assess a stock market's strength and solidness in the LLSV-research include a range of proxies for amongst others stock market capitalization, number of domestic publicly traded firms in each country (relative to its population), stock market liquidity (e.g. measured by the ratio of traded volume to GDP), share ownership structure, proxies measuring private benefits of control etc.

[184] Most notably in this regard: LA PORTA, LOPEZ-DE-SILANES and SCHLEIFER, 'What Works', 1-32.

[185] *Ibid.* 27-28. See in the same sense: DJANKOV, LA PORTA, LOPEZ-DE-SILANES and SCHLEIFER, 'The Law and Economics of Self-Dealing', 430-465.

[186] Idem.

[187] See for instance: WORLD BANK, World Bank, Institutional foundations for financial markets, 2006, available at: siteresources.worldbank.org, which picked up the LLSV standpoints (p.6), promoting private enforcement as a means to enhance and strengthen market development and economic growth. Drawing from this literature: (with regard to Italy)

impact however, the LLSV-research also became the subject of substantial criticism. The criticism pertained to the research method and indices developed by the scholars, and by result, affected also the conclusions drawn from their analyses.[188] One of the most important criticisms concerned the rather formal character of the indices used to measure the financial development of the countries compared and coding errors detected by other scholars.[189] The authors were also criticized for approaching the issues from a predominant common law perspective, failing to observe other mechanisms that may function as substitutes for (formal) private enforcement actions (see below).[190]

55. The criticism spurred the debate causing other scholars to consider the potential effect of public versus private enforcement on securities markets development.[191] ROE and JACKSON assessed the relevance of public enforcement not by measuring the powers of public officials (as would be the course to follow in the LLSV method) but instead measured the staffing level and budget of several public authorities supervising securities markets.[192] Based on their findings and contrary to the LLSV-research, these authors argue that public enforcement has an impact on the development of financial markets. Moreover, based on their findings, they state that solid public enforcement may be a prerequisite to effective private enforcement since the latter may be dependent on public enforcement mechanisms in terms of detection and policing of the market.[193] Reference is made to research indicating that private enforcement is far more likely to emerge once an SEC public enforcement

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FERRARINI and GIUDICI, 'Financial Scandals', 159-214. See also on this topic: PERRONE and VALENTE, 'Investor protection in Italy', 33 ff.; (France) SPITZ, *La réparation*, 88. Considering the central role attributed to private enforcement with regard to financial market development too hastily drawn and lacking sound evidence supporting this assertion: JACKSON and ROE, 'Public and Private Enforcement', 209.

[188] SIEMS and DEAKIN, 'Comparative Law and Finance', 122; H. SPAMANN, 'Law and Finance' Revisited', 2008, Harvard Law School John M. Olin Center, Discussion Paper No. 12, http://ssrn.com/abstract=1095526 52 p.; H. SPAMANN, 'On the Insignificance and/or Endogeneity of La Porta et al.'s 'Anti-Director Rights Index' under Consistent Coding', 2006, ECGI Law Working Paper No. 67/2006 103 p.; K.W. DAM, 'Equity Markets, the Corporation, and Economic Development', 2006, John M. Olin Law & Economics Working Paper No. 280, available at SSRN: http://ssrn.com/abstract=885196 8 ff.; S. FAGERNÄS, P. SARKAR and A. SINGH, 'Legal origin, shareholder protection and the stock market: New challenges from time series analysis', 2007, Centre for Business Research, University of Cambridge, Working Paper No. 343 , available at http://www.cbr.cam.ac.uk 33; M. BERNDT, 'Global differences in corporate governance systems - Theory and Implications for Reforms', 2002, Harvard Law and Economics Discussion Paper No. 303, available at SSRN: http://ssrn.com/abstract=255886 65; See also: J. ARMOUR, S. DEAKIN, P. SARKAR, M.M. SIEMS and A. SINGH, 'Shareholder protection and stock market development: an empirical test of the legal origins hypothesis', 6 *J. Empirical Legal Stud.*, 2009, iss. 2, 343.

[189] See for instance with regard to coding errors relating to Belgium and France: S. COOLS, 'The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers', 30 *Del. Journ. Corp. L.*, 2005, 697; with regard to the LLSV results concerning Germany and the UK, see: BERNDT, 'Global differences', 65; finding the research limited in terms of the connection between strong legislation and the (public) regulator: SPAMANN, 'Law and Finance', 52 p.; SPAMANN, 'On the Insignificance and/or Endogeneity', 103 p. See also: ARMOUR, DEAKIN, SARKAR, SIEMS and SINGH, 'Shareholder protection', 343, 5, ftn. 4 in particular; Stressing the weight of formal criteria in the LLSV-research regardless of their practical importance and asserting an overbroad conclusion was consequently reached: COFFEE, 'Law and the Market', 250. For an overview of the criticism: DAM, 'Equity Markets', 8 ff.

[190] See for instance in the UK context: ARMOUR, DEAKIN, SARKAR, SIEMS and SINGH, 'Shareholder protection', 343; M.M. SIEMS, 'The Foundations of Securities Law', 20 *EBLR* 2009, 141; COOLS, 'Real Difference in Corporate Law', 697; DAM, 'Equity Markets', 39 p.

[191] JACKSON and ROE, 'Public and Private Enforcement', 207; COFFEE, 'Law and the Market', 229; J. ARMOUR, 'Enforcement strategies in UK corporate governance: a roadmap and empirical assessment', 2008, ECGI Law Working paper n° 106/2008, available at: http://papers.ssrn.com/, 64p.; see on this topic also: ROSE, 'Reforming Securities Litigation Reform', 1301-1364; and A. ROSE, 'The multi-enforcer approach to securities fraud deterrence: a critical analysis', 158 *U. Pa. L. Rev.*, 2010, 2173-2231. On a global level see for instance: CARVAJAL and ELLIOTT, 'Strengths and Weaknesses', 19 ff.

[192] JACKSON and ROE, 'Public and Private Enforcement', 207. See with regard to the relevance of stronger securities regulation and enforcement of the this regulation (based on – among other things – measuring the supervisory resources through staff levels) also: CHRISTENSEN, HAIL and LEUZ, 'Capital-Market Effects of Securities Regulation', 70 p.

[193] JACKSON and ROE, 'Public and Private Enforcement', 210.

action has been initiated.[194] Although no conclusive evidence has been provided yet, other research – mainly carried out in a US context – offers further support for ROE and JACKSON's assertion that the impact of public enforcement might not be as negligible as contended by the LLSV-research. COFFEE for instance built further on this stream of literature, adding that not the input (staffing levels and budget) of public enforcement should be examined in order to analyze the correlation between financial market development and enforcement, though instead the output should be measured. COFFEE more particularly considered the number of enforcement actions initiated, the financial penalties imposed by the regulator and the part of the budget dedicated to enforcement to measure the impact of public enforcement on financial market development.[195] Based on his findings, COFFEE rather supports reliance on public than private enforcement in the context of US securities law. Other (US) commentators have followed this lead.[196]

C. Resonance of the private/public enforcement debate in the EU

56. Following the US driven academic debate on private enforcement of securities laws, European scholars started similar discussions about the role of private litigation in capital market law enforcement. In line with the LLSV-literature, they found that EU Member States indeed show a significant lower degree of private investor enforcement of securities laws, whereas the intensity of (formal) public enforcement is generally observed to be at a considerably lower level too.[197] Carrying out research on UK corporate and financial law enforcement vis-à-vis listed companies, ARMOUR for instance finds that formal private enforcement of UK corporate and securities law is relatively insignificant, if not zero, in the UK context.[198] ARMOUR also found that formal public enforcement (i.e. actions that consist of issuing fines or other sanctions through judicial or quasi-judicial proceedings) has also been relatively low in the UK.[199] Instead of these formal actions, Armour found that in the UK enforcement was carried out through informal enforcement activities undertaken by

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[194] *Ibid.* 210, with reference to: J.D. COX, T.S. RANDALL and D. KIKU, 'SEC Enforcement Heuristics: An Empirical Inquiry', 53 *Duke L. J.*, 2003, 737.

[195] COFFEE, 'Law and the Market', 229.

[196] ROSE, 'Reforming Securities Litigation Reform', 1301-1364; and ROSE, 'The multi-enforcer approach', 2173-2231.

[197] H.E. JACKSON, 'Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications', 24 *Yale J. on Reg.*, 2007, iss. 2, 253, 282 in particular. See also: VEIL, *Europäisches Kapitalmarktrecht*, 215-216, 371; W.-G. RINGE and A. HELLGARDT, 'The international dimension of issuer liability', 31 *Oxford J. Legal Studies*, 2011, iss. (1), 29; SIEMS, 'EU Market Abuse Directive', 39; (Italy) FERRARINI and GIUDICI, 'Financial Scandals', 159 ff.; GIUDICI, 'Private law enforcement', 36p.; (UK) ARMOUR, 'Enforcement strategies', 17-18; J. ARMOUR, B. BLACK, B. CHEFFINS and R. NOLAN, 'Private enforcement of corporate law: an empirical comparison of the United Kingdom and the United States', 6 *J. Empirical Legal Stud.*, 2009, iss. 4, 689; E. FERRAN, 'Are US-style investor suits coming to the UK', 9 *JCLS*, 2009, 342 ff.; (France) O. DOUVRELEUR, 'La sanction en droit boursier', Y. CHAPUT, *La Sanction: la lecture des économistes et des juristes*, Bruxelles, Bruylant, 2011, 107-108. With regard to the enforcement of insider dealing, see for instance: E. ENGLE, 'Insider Trading in U.S. and E.U. Law: A Comparison', 26 *EBLR* 2010, 465-490; SPITZ, *La réparation*, 209 and 235, ftn. 74; and A. PIETRANCOSTA, 'Délits boursiers: la réparation du préjudice subi par l'investisseur', *RTD Fin.*, 2007, 21-27 (with regard to (the lack of) private enforcement). See in a broader EU context with regard to private enforcement also: Note that with regard to public supervision and enforcement of EU financial law the High level Group reported overall 'weak and heterogeneous' sanction regimes across the different Member States, calling for action in this area (which has lead to concrete steps in the mean time). Report High Level Group on Financial Supervision in the EU, Brussels, 25 February 2009, available at: http://ec.europa.eu/internal_market, p. 23, para. 83 and 84.

[198] ARMOUR, 'Enforcement strategies', 17-18; ARMOUR, BLACK, CHEFFINS and NOLAN, 'Private enforcement of corporate law', 711. See with regard to securities law enforcement also: P. DAVIES, 'Liability for misstatements to the market: Some reflections', 9 *JCLS* 2009, 315, also noting that public enforcement "in the past seems not to have accorded a high priority to the continuing disclosure obligations. Whether this will change is unclear."

[199] Over the last few years, considerable efforts have been made to increase the level of (formal) public enforcement in the UK. See further below in this regard.

(public) agencies on the one hand[200], and by (private) institutional investors in response to managerial failures on the other.[201] ARMOUR therefore concluded that the distinction between formal and informal enforcement proved in fact more relevant to the UK analysis than the distinction between private and public enforcement.[202] It should also be noted that even though formal public enforcement has been relatively low for a long a time in the UK, efforts have been made to intensify formal public enforcement actions in various fields of financial law, including insider trading and other forms of market misconduct.[203]

57. The distinction between formal and informal enforcement actions as made by ARMOUR is very interesting as it illustrates the complexity of the enforcement debate once more. Various mechanisms and forms of enforcement exist and interact with each other, rendering comparisons between jurisdictions with differently organized enforcement systems difficult and complicated.[204] Another illustration of this latter observation is offered by PERRONE & VALENTE who observe that the US scholarly literature has studied the impact of private enforcement on stock market development exclusively from the perspective of issuer liability, while not taking note of liability claims directed against intermediaries distributing financial products to the investor public.[205] PERRONE & VALENTE note that even though liability claims focusing on the issuer-investor relation may be scarce in Italy, an alternative model that focuses on the relation between investors and intermediaries may have emerged with investor protection standards that ensure deterrence and investor compensation in an alternative, yet comparable fashion. The observation that private enforcement focused on the relationship between investment firms and investors bears relevance and may offer an alternative approach to investor protection should not be neglected in analyzing potential correlations between market development and enforcement structures. This observation and its importance have not been entirely lost on US scholars either. ROE & JACKSON for instance also highlighted the importance of reliable trading channels.[206]

58. Notwithstanding these nuances however, it remains a fact that overall, enforcement intensity – both private and public – appears to be less intense to at least some degree on this side of the Atlantic.

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[200] Informal public enforcement is defined as investigations or guidance that results in no more than a private conversation between the regulator and the firm in question, as opposed to investigations resulting in public notices, awards of compensation, or other remedial orders. ARMOUR, 'Enforcement strategies', 19 ff; ARMOUR, BLACK, CHEFFINS and NOLAN, 'Private enforcement of corporate law', 721. See in this context also: FERRAN, 'Capital market competitiveness', 5.

[201] Idem. These informal private enforcement mechanisms are to be situated in company law more than securities law however, and mostly protect shareholder rights, yet no initiatives preventing misleading disclosures are cited in the analysis.

[202] A similar remark has been made with regard to France: P. CLERMONTEL, *Le droit de la communication financière*, Paris, Joly Editions, 2009, 419, para. 635; with reference to: S. PORTELLI, 'Les sanctions pénales en matière économique et financière', *PA* 2006, nr. 9, 11.

[203] E. FERRAN, 'Regulatory lessons from the PPI Mis-selling scandal', 13 *EBOR* 2012, iss. 2, 261. See also: P. HINTON and R. PATTON, 'Trends in Regulatory Enforcement in UK Financial Markets: Fiscal Year 2011/12', 2012, NERA publications, http://www.nera.com 40 p. In line with the increasing attention for financial law enforcement, the former FSA (now FCA) has introduced a different approach and increased the level of (public) enforcement of securities law. For an overview, see for instance: A. HAYNES, 'Market abuse, fraud and misleading communications', 19 *JFC* 2012, 234 and various annual reports published on the FCA official website.

[204] Similar: FERRAN, 'Capital market competitiveness', 3. FERRAN points out that COFFEE correctly states that the US has an exceptional rate of formal public enforcement actions with regard to securities laws when compared to the UK, yet as enforcement is defined in terms of formal *ex post* (repressive) enforcement only, it fails to take into account whether a lesser degree of formal enforcement is complemented or supported by other techniques aimed at ensuring compliance.

[205] PERRONE and VALENTE, 'Investor protection in Italy', 31. See in this regard also: JACKSON and ROE, 'Public and Private Enforcement', 209: "Trading channels have not been the focus of analysis in the law and finance writing of the past decade, yet reliable trading channels might be critically important to building a strong securities market."

[206] JACKSON and ROE, 'Public and Private Enforcement', 209.

With regard to public enforcement for instance, not only the outcome in terms of formal sanctions was found to be substantially higher in the US, the resources spent on staffing and budget for financial regulators appeared significantly higher too.[207] With regard to private enforcement, the differences are even more remarkable when taking into account that monetary sanctions awarded by the SEC are only a fraction of the damages collected by means of investor litigation, whereas with regard to some areas of law – such as ongoing reporting obligations – private enforcement is nearly absent in some Member States. These findings as well as other reports[208] raised concerns regarding the level of public enforcement in the Member States, while the current state of play with regard to private enforcement has been considered too low in terms of intensity and impact to fill the gap that might be left by the lower public enforcement level.[209]

59. These concerns on enforcement and the underutilization of private enforcement in the context of EU capital market law are not only discussed by academics but also draw attention – gradually and at different speeds – at the national political levels of the Member States, spurring certain legal changes and facilitations of investor claims.[210] Moreover, not only the national authorities show an increasing interest, but the European level as well has made tentative moves in the direction of the private enforcement debate. Recent legislative initiatives initiated by the Commission display an increasing interest in using civil liability as a tool to ensure compliance with EU capital market law. [211]

III. Private enforcement of EU capital market law

60. Private enforcement. – Enforcement of European capital market law is generally situated on three levels, being the administrative, criminal (penal) and civil enforcement level. The reforms and initiatives following the financial crisis and aimed at the installment of a stricter and more harmonized enforcement structure predominantly concern public enforcement actions.[212] The role of private

[207] JACKSON, 'Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications', 253; COFFEE, 'Law and the Market', 229; JACKSON and ROE, 'Public and Private Enforcement', 207.

[208] See for instance: Report High Level Group on Financial Supervision in the EU, Brussels, 25 February 2009, available at: http://ec.europa.eu/internal_market, p. 23, para. 83 and 84.

[209] RINGE and HELLGARDT, 'International dimension', 29; SIEMS, 'EU Market Abuse Directive', 39; (Italy) FERRARINI and GIUDICI, 'Financial Scandals', 159 ff.; GIUDICI, 'Private law enforcement', 36p.; (France) DOUVRELEUR, 'La sanction en droit boursier', 107-108; SPITZ, *La réparation*, 209 and 235, ftn. 74; and PIETRANCOSTA, 'Délits boursiers', 21-27; (with regard to the UK) FERRAN, 'US-style investor suits', 315; DAVIES, 'Liability for misstatements', 315 discussing the very limited private enforcement regime applicable to misleading issuer reporting obligations: "If public enforcement cannot pick the weight the statutory liability scheme implicitly accords it, the restrictions on private enforcement may become a matter of regret."

[210] See further below, in the next chapters.

[211] See *infra* (para. 66 ff.).

[212] Following a mandate from the European Commission to analyze weaknesses and shortcomings of the current EU legal framework in the aftermath of the recent financial crisis, the High-Level Group on Financial Supervision in the EU (de Larosière Group) reported that the current national supervisory and sanction regimes in the Member States are 'weak and heterogeneous' and invite regulatory arbitrage. Report High Level Group on Financial Supervision in the EU, Brussels, 25 February 2009, available at: http://ec.europa.eu/internal_market, p. 23, para. 83 and 84 in particular. The report prompted the Commission to communicate its intention to improve and intensify the enforcement of EU financial law on the national level coupled to the installment of a new supervisory structure at the EU level and mechanisms to improve coordination and cooperation between supervisors on the national level. EUROPEAN COMMISSION, Communication, Reinforcing sanctioning regimes in the financial sector, COM (2010) 716, December 8, 2010, available at: http://ec.europa.eu/internal_market, 16p. The Commission proposed to promote convergence between the regimes by means of minimum common standards which should address the appropriate types of administrative sanctions for violations of key provisions of EU legislative acts, the publication of sanctions, the level of administrative fines to ensure the effective proportionate and dissuasive effect of the sanction, the criteria to be taken into account to apply sanctions etc. Besides administrative sanctions, criminal sanctions as well have received the Commission's attention: EUROPEAN COMMISSION, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Towards an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law, COM(2011)

enforcement however has remained somewhat under the radar, although occasional references to liability sanctions have surfaced in some of the EU capital market directives (see below). Additionally, considering that incentives to ensure compliance with EU legislation can be provided by ensuring that consumers have the means to obtain redress from the authors of a violation wherever they have suffered harm, the Commission also announced to launch a public consultation on collective redress, including consumer redress in the financial services sector.[213] Other initiatives as well demonstrate an increasing interest at the EU level in the role of private enforcement mechanisms as an instrument to strengthen the EU legal framework. The impact of EU rules in terms of private enforcement of EU capital market law and recent initiatives in this regard are discussed in more detail in the next section.

A. Private enforcement of investor protection measures: the impact of EU capital market law

1. Private enforcement of obligations imposed by EU capital market law

a. Minimalistic approach in EU capital market legislation

61. Prospectus and Transparency Directive. – Several capital market law directives explicitly refer to civil liability as a means to enforce its contents, being the Prospectus Directive, UCITS, the AIFMD, the CRA Regulation and the Transparency Directive.[214] The Prospectus Directive particularly requires that "Member States shall ensure that their laws, regulation and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus".[215] In a similar manner, the Transparency Directive holds that "[Member States] shall ensure that their laws, regulations and administrative provisions on liability apply to the issuers, the bodies referred to in this Article or the persons responsible within the issuers."[216] In addition, art. 28 Transparency Directive requires the Member States to ensure "[…] in conformity with their national law, that at least the appropriate administrative measures may be taken or civil and/or administrative penalties imposed in respect of the persons responsible, where the provisions adopted in accordance with this Directive have not been complied with […]".[217] These requirements are rather general in nature and seem satisfied when national liability law applies in case of violations against the Prospectus Directive and the Transparency Directive, yet these directives do not seem to affect the contents and substance of the Member States' national private laws.

573 final, 20 September 2011, available at http://ec.europa.eu/, p. 10 in particular (with regard to criminal sanctions for insider trading and market abuse. These plans have also been made concrete as the Commission launched its proposal for a directive on criminal sanctions for insider dealing and market manipulation. EUROPEAN COMMISSION, Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation, COM (2011) 654 final, 12 October 2011, available at: http://eur-lex.europa.eu, p.14.

[213] COMMISSION, Communication, Reinforcing sanctioning regimes in the financial sector, COM (2010) 716, p. 4.

[214] Art. 6 (2) Prospectus Directive; consideration (17) and art. 7 and art. 28 Transparency Directive; art. 24 and 34 UCITS; art. 21(12)-(15) AIFMD; Art. 35a Regulation (EC) No 1060/2009 of the European Parliament and the Council of 16 September 2009 on credit rating agencies, *OJ* L 302/1 as amended by Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) 1060/2009 of the European Parliament and the Council of 16 September 2009 on credit rating agencies, *OJ* L 146/1 (CRA Regulation).

[215] Art. 6 (2) Prospectus Directive.

[216] Art. 7 Transparency Directive.

[217] Art. 28 Transparency Directive.

62. UCITS. – The UCITS directive on the other hand requires Member States to ensure out of court-redress mechanisms to settle consumer disputes[218], while also providing for liability rules applicable to depositaries, that is, institutions entrusted with the safe-keeping of the assets of a collective fund and charged with a gate keeping function vis-à-vis the management company that manages the assets.[219] With regard to depositaries, it is for instance stated that liability is incurred vis-à-vis the management company and the unit-holders for losses suffered as a result of its unjustifiable failure to perform its obligations, or its improper performance of them.[220] The applicable liability regime depends on the national law of the investment company's home Member State and cannot be avoided by delegating the safe-keeping of some or all of the assets to a third party.[221] As was highlighted in the aftermath of the *Madoff*-scandal, however, the national standards for depositary liability differ to a substantial degree across Member States, causing inconsistencies in the level of investor protection within EU Member States.[222] In attempt to resolve this problem for the future, the pending UCITS-V-Proposal proposes the introduction of harmonized liability rules for UCITS depositaries. The proposed liability rules are discussed further below[223], yet it is already pointed out that the proposed liability rules resemble the liability rules imposed on depositaries by the AIFMD.

63. AIFMD. (Strict) Liability imposed on AIF depositaries. – The AIFMD provides for rules imposing strict liability on depositaries for loss of financial instruments held in custody by the depositary, as defined in art. 100 AIF Delegated Regulation[224], even if the loss of instruments occurred with a sub-custodian to whom the custody has been delegated.[225] The depositary is liable for loss of financial instruments in all cases of loss, regardless of fault, and can only discharge liability if the depositary proves that loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts.[226] The strict liability standard is triggered upon 'loss' of financial instruments as defined in art. 100 AIF Delegated Regulation. For example, according to art. 100 AIF Delegated Regulation, loss of financial instruments occurs in situations in which a stated right of ownership of the AIF is demonstrated not to be valid because it either ceased to exist or never existed, or the fund has been definitively deprived of its right of ownership over the financial instrument, or the fund is definitively unable to directly or

[218] Art. 100 UCITS.

[219] Art. 2 (1) a) UCITS defines the concept "depositary".

[220] Art. 34 UCITS.

[221] Art. 34 and art. 32 UCITS.

[222] See UCITS-V-Proposal. In order to get a better insight in these inconsistencies in investor protection, CESR (now ESMA) prepared a report, mapping the duties and liabilities of UCITS depositaries which indeed shows a diversity in liability rules: CESR, Mapping of duties and liabilities of UCITS depositaries, 2010, January, available at: http://www.esma.europa.eu/, 121p.

[223] *Infra* para. 68.

[224] Strict liability is more particularly triggered by the 'loss of financial', which has been defined as situations in which a stated right of ownership of the AIF is demonstrated not to be valid because it either ceased to exist or never existed; the fund has been definitively deprived of its right of ownership over the financial instrument; or the fund is definitively unable to directly or indirectly dispose of the financial instrument (art. 100 (1) (a), (b) and (c) Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision, *OJ* L 83/1 (AIF Delegated Regulation). See also: P. MCGOWAN and K. EVERITT, 'New Requirements Imposed on the European Alternative Investment Funds Industry', 14 *Bus. L. Int'l*, 2013, no. 2, 105.

[225] Art. 100 (5) AIF Delegated Regulation: "A loss of a financial instrument held in custody shall be ascertained irrespective of whether the conditions listed in paragraph 1 are the result of fraud, negligence or other intentional or non-intentional behaviour."

[226] Art. 21(12) AIFMD.

indirectly dispose of the financial instrument.[227] The depositary is liable for losses other than loss of financial instruments vis-à-vis investors and the fund only to the extent the loss has been suffered as a result of the depositary's negligent or intentional failure to properly fulfill its obligations pursuant to the AIFMD.[228]

64. CRA Regulation. – A final example of European legislation imposing liability rules for violations can be found in the CRA Regulation, which imposes liability on credit rating agencies vis-à-vis investors for loss caused by intentional or grossly negligent committed infringements listed in the third Annex to the CRA Regulation.[229] Other than the aforementioned Prospectus and the Transparency Directive, the CRA Regulation also contains more detailed provisions stating that the investor or issuer who demands damages for grossly negligent or intentional violations of the CRA Regulation must present evidence of the infringement and its impact on the credit rating.[230] Furthermore, art. 35a CRA Regulation holds that an investor may claim damages insofar it is established that he has reasonably relied on a credit rating in making an investment decision.[231] Limitations on civil liability imposed on credit rating agencies are subject to the conditions set out in art. 35a (3) CRA Regulation. National liability law remains of considerable importance, however, as requirements such as 'intention', 'gross negligence', 'reasonably relied', 'causation' and the like are to be interpreted according to the applicable national law as determined by the relevant rules of private international law.[232] It seems obvious that these requirements will be interpreted differently across the Member States, and thus only have a rather limited effect in terms of harmonization.[233] Furthermore, in a reaction to the responses and reactions to the public consultation conducted prior to the proposal and the enactment of the amendments, the Commission also clarified that civil liability should be applied with caution vis-à-vis credit rating agencies, meaning that it should be reserved for 'severe cases only' and 'not simply where investors suffer loss'.[234]

65. Conclusion. – Except for more recent legislation, such as the CRA Regulation and the AIFMD, civil liability rules enacted by the EU legislator essentially boil down to the obligation for the Member States to declare their general civil liability regime applicable in case of infringements. Hence, the directives redirect investors who have suffered losses due to violations of these directives to the national liability rules of the Member States to seek redress without formulating any specific

[227] Art. 100 (1) AIF Delegated Regulation.

[228] Rec. (44) and art. 21(12) AIFMD.

[229] Art. 35a CRA Regulation.

[230] Art. 35a (2) CRA Regulation.

[231] Art. 35a (3) CRA Regulation. Liability for infringements listed in the third Annex is only incurred insofar the credit ratings have been reasonably relied on, in accordance with art. 5a (1) CRA Regulation that states that the ratings should not be mechanically relied on, nor solely relied on by financial and credit institutions (as listed in art. 4 (1) CRA) since the latter are required to make their own credit risk assessment. In other cases too, liability only emerges to the extent the ratings have been relied on 'with due care', according to art. 35a (1) CRA Regulation.

[232] Art. 35a (4) CRA Regulation and rec. (35) Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) 1060/2009 of the European Parliament and the Council of 16 September 2009 on credit rating agencies, *OJ* L 146/1.

[233] Similar: R. FOX and B. HAMMOND, 'The proposed civil liability regime for EU credit rating agencies: too far too fast?' *JIBFL* 2012, 426-429; H. EDWARDS, 'CRA 3 and the liability of rating agencies: inconsistent messages from the regulation on credit rating agencies in Europe', 7 *LFMR* 2013, nr. 4, 186. This is also illustrated by the new legislation enacted in the UK in response to the EU rules and stating the interpretation of several of these requirements in a rather restrictive manner. See *infra*, para. 191.

[234] The European Commission conducted a public consultation from 5 November 2010 to 7 January 2011. Approximately 100 responses were filed in response, an overview of which can be consulted in: Overview of responses to Public Consultation on Credit Rating Agencies, available at: http://ec.europa.eu/internal_market.

requirements as to the content of those rules.[235] The AIFMD and the CRA Regulation on the other hand specify the standard of liability, yet leave the interpretation of concepts such as 'intent', 'negligence' and the like, to the national courts. As for MiFID and the Market Abuse Directive (and the future Market Abuse Regulation), it should be noted that no provisions regarding civil liability were included. The reason why liability provisions were included in the some directives, such as the Prospectus and Transparency Directive, but not in others, such as the Market Abuse Directive, nor in the (future) Market Abuse Regulation and MiFID is unclear.[236]

b. Increased attention for (private) enforcement of EU capital market law

66. Although (harmonized) liability rules only occur on a very fragmented and limited basis and are in fact still mostly absent in many areas of EU capital market law, the EU level has not remained oblivious to the technique of civil liability as a tool to enforce EU capital market law. Various initiatives have demonstrated an increasing awareness – and even eagerness at the Commission level – with respect to the private enforcement of EU capital market law. During the drafting process of the Prospectus Directive for instance, the German government launched a proposal to harmonize the national prospectus liability regimes.[237] Since the proposal failed to earn the support of the other Member States however, no such harmonized liability rule was (yet) introduced.[238] A new, modest attempt in the context of prospectus liability was undertaken during the revision of the Prospectus Directive with regard to misleading information in the prospectus summary. In the initial proposal, the Commission proposed to abandon the 2.500-words limit applicable to the prospectus summary and stated that, as "a logical consequence of having a more substantial summary", civil liability should also be attached to the summary in case "it does not provide key information enabling investors to take informed investment decisions and to compare the securities with other investment products".[239] In the final version adopted by the authorities however, this phrasing was amended and now states that "[…] Member States shall ensure that no civil liability shall attach to any person solely on the basis of the summary, including any translation thereof, unless it is misleading, inaccurate or inconsistent, when read together with the other parts of the prospectus, or it does not provide, when read together with the

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[235] See in this respect also: R. VEIL, 'Enforcement of Capital Markets Law in Europe – Observations from a Civil Law Country', 11 *EBOR* 2010, iss. 3, 411, noting that [with regard to the Prospectus Directive, the Transparency Directive, MiFID and the Market Abuse Directive] the EU legislator imposed no precise requirements concerning the enforcement."

[236] It is noted that other EU capital market law directives – such as Takeover Bid Directive– do not contain civil liability rules either. See in this regard also: A. HELLGARDT, 'Europarechtliche Vorgaben für die Kapitalmarktinformationshaftung – de lege lata und nach Inkrafttreten der Marktmissbrauchsverordnung', *AG*, 2012, heft 5, (154) 156; with regard to the Takeover Bid Directive, see also: P. DAVIES, E.-PH. SCHUSTER and E. VAN DE WALLE DE GHELCKE, 'The Takeover Directive as a Protectionist Tool?', February, 2010, ECGI Law Working Paper N°. 141/2010, available at: http://ssrn.com/abstract=1554616, 56p.

[237] Council document, 'Proposal for a Directive of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading', Brussels I, 28 June 2002 (ref. 9884/02 EF 51 ECOFIN 215 DRS 41 CODEC 751), (2.).

[238] Council document, 'Proposal for a Directive of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading', Brussels I, 28 June 2002 (ref. 9884/02 EF 51 ECOFIN 215 DRS 41 CODEC 751), (2.); see also: SCHAMMO, *EU Prospectus Law*, 241.

[239] This in addition to liability attached to summary information that is misleading, inaccurate or inconsistent, when read together with other parts of the prospectus; Commission, Proposal for a directive of the European Parliament and of the Council amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Brussels, 23 September 2009, COM(2009) Final, available at http://ec.europa.eu, p. 7-8. See for a more extensive discussion, also in relation with summary information of key information documents in the context of UCITS and the PRIPs-proposals: BURN, 'KISS, but tell all: short-form disclosure for retail investors', 149 ff.

other parts of the prospectus, key information in order to aid investors when considering whether to invest in such securities. The summary shall contain a clear warning to that effect".[240] The attempt of the Commission to attach civil liability to the summary thus seems to have been to no avail either.

During the revision of MiFID, the matter was again on the table as the Commission's consultation document explicitly tested the waters for a harmonized liability rule applicable to investment firms. The consultation document particularly inquired whether the introduction of a civil liability principle, which would be imposed on investment firms relating to the investment services offered, would contribute to the equal protection of investors in the EU.[241] It was furthermore suggested that a principle of civil liability could be introduced in areas concerning the relationship between firms and clients, and particularly regarding specific obligations towards the client. These areas included information requirements, the suitability and appropriateness test, reporting requirements, best execution and client order handling. The consultation did not mention the extent to which the suggested civil liability rules would interfere in the national private law systems. Similar to the proposals launched during the drafting process of the Prospectus Directive, however, this initiative seems to have failed too since no further proposals or suggestions were included in the Commission's final proposal.[242]

67. Notwithstanding these two examples of failed attempts to introduce harmonized liability rules, some other initiatives proved more successful. The recently amended regulation applicable to credit rating agencies and the AIFMD – discussed in the preceding paragraphs – are worth mentioning in this regard, while recent legislative initiatives seem to go further down this path and continue to make efforts to harmonize the Member States' liability rules to at least some degree.[243] The pending UCITS-V-Proposal and the pending proposal concerning packaged retail investment products (PRIPS) and the key information document (KID) can be pointed out in this regard.[244] The pending proposal for PRIPS-Regulation for instance contains introduces a harmonized liability rule stating that the manufacturer of investment products may incur liability vis-à-vis retail investors for any loss caused to that retail investor through the use of the key information document that does not comply with the requirements set out in the regulation.[245] Along with the suggestion to introduce a harmonized liability rule, the

[240] Amended art. 6(2) according to art. 6 Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, *OJ* L. 327/1. Recital (16) of this amending directive simply holds that "Member States shall ensure that no civil liability shall attach to any person solely on the basis of the summary, including any translation thereof, unless it is misleading, inaccurate or inconsistent, when read together with the other parts of the prospectus", which is a mere repetition of the old art. 6(2) Prospectus Directive.

[241] European Commission, Public consultation: Review of the Markets in Financial Instruments Directive (MiFID), 2010, 8 December, ec.europa.eu, 63, para. 7.2.6: "While investment firms are subject to possible administrative sanctions by the competent authorities if they infringe MiFID rules, the directive does not deal with the liability of firms towards clients in cases where infringement of MiFID rules causes damage. Thus, the conditions for such civil liability vary according to Member States' civil legal orders and may sometimes be difficult to establish. […]. Introducing a principle of civil liability of investment service providers would be essential for ensuring an equal level of investor protection in the EU". See also para. 7.2.7. for a similar point of view expressed with regard to attaching civil liability consequences to violations of the best execution principles. See also: D. BUSCH, 'MiFID II: Europese aansprakelijkheid van beleggingsondernemingen', *T.F.R.* 2011, 57-58.

[242] See also: SCHAMMO, *EU Prospectus Law*, 241.

[243] Art. 35a CRA Regulation as amended by Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) 1060/2009 of the European Parliament and the Council of 16 September 2009 on credit rating agencies, *OJ* L 146/1. Art. 21(12)-(15) AIFMD.

[244] European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM (2012/0169, 352 final, Brussel 3 July 2012, available at http://eur-lex.europa.eu.

[245] Art. 11 of the pending proposal for PRIPS-Regulation.

Commission also proposes to introduce harmonized rules with regard to the burden of proof to establish liability.[246] Whereas a reversal of the burden of proof is proposed with regard to the establishment of the breach of law (i.e. that the key information document was drawn up in compliance with the relevant legal provisions), the demonstration of the causal link between the deficient information and the loss would be left with the investor, according to the proposal.[247]

68. The pending UCITS-V-Proposal on the other hand also seeks to remedy the existence of different liability standards applicable to depositaries for loss of financial instruments and for losses incurred as a result of its negligent or intentional failure to properly fulfill its obligations, as the *Madoff*-scandal clearly demonstrated that different levels of investor protection exist in the Member States in this regard.[248] More particularly, the UCITS-V-Proposal seeks to harmonize the rules by introducing strict liability for depositaries in the event of loss of financial instruments, even if the loss occurred with a sub-custodian.[249] Only in case the loss resulted from an external event beyond its reasonable control and with consequences that were unavoidable despite all reasonable efforts to the contrary, the depositary will be discharged.[250] A similar regime as the one proposed in the pending UCITS-V-Proposal has been enacted in the AIFMD, including the strict liability standard imposed on depositaries.[251] Secondly, depositaries should also be held liable for losses incurred as a result of its negligent or intentional failure to properly fulfill its obligations.[252] The latter liability may be incurred for instance in situations in which the loss consists of the loss of the value of assets, if, for example, a depositary tolerated investments that were not compliant with fund rules, while exposing the investor to unexpected or anticipated risks.[253]

69. Compared to the Prospectus Directive and the Transparency Directive, more recent EU capital market legislation (or proposals) seems to go further and formulate more detailed rules concerning the standard of liability and even evidential rules, imposing the burden of proof on one of the parties

[246] Art. 11, European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM (2012/0169, 352 final, Brussel 3 July 2012, available at http://eur-lex.europa.eu.

[247] "As retail investors in general do not have close insight as to the internal procedures of investment product manufacturers, a reversal of the burden of proof should be established. The product manufacturer would have to prove that the key information document was drawn up in compliance with this Regulation. However, it would be for the retail investor to demonstrate that his loss has occurred due to the use of the information in the key information document because this matter falls within the direct personal sphere of the retail investor. Rec. (17), European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012/0169, 352 final, Brussel 3 July 2012, available at http://eur-lex.europa.eu.

[248] Amended art. 24 UCITS-V-Proposal (pending).

[249] Amended art. 24 UCITS-V-Proposal (pending).

[250] Amended art. 24 UCITS-V-Proposal (pending).

[251] According to art. 21 (12) AIFMD depositaries are liable vis-à-vis investors and the fund for the loss of financial instruments by the depositary or a third party to whom the custody of financial instruments has been delegated. The depositary is liable in all cases of loss, regardless of fault, and can only exonerate in case the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts. The strict liability standard is triggered upon 'loss' of financial instruments and covers for various scenarios such as situations in which a stated right of ownership of the AIF is demonstrated not to be valid because it either ceased to exist or never existed; the fund has been definitively deprived of its right of ownership over the financial instrument; or the fund is definitively unable to directly or indirectly dispose of the financial instrument (art. 100 (1) (a), (b) and (c) Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision, *OJ* L 83/1 (AIF Delegated Regulation). Rec. (113) further clarifies that this does not imply investment losses for investors resulting from a decrease in the value of assets as a consequence of an investment decision. See also *supra*, para. 63.

[252] Amended art. 24 UCITS-V-Proposal (pending).

[253] Rec. (7) UCITS-V-Proposal (pending).

involved. As these recent initiatives clearly acknowledge however, national law continues to play a crucial role regarding the interpretation and application of liability requirements such as 'damage', 'causation', 'gross negligence', 'intent' and evidential rules, leaving considerable room for different national liability regimes notwithstanding the introduction of certain harmonized rules or principles. With regard to prospectus liability rules for instance, the Commission requested ESMA to compile a comparative table compiling the liability regimes applied by the Member States.[254] Drawing the report, ESMA concluded that there are some commonalities between the jurisdictions, yet the range of possible manners to organize civil liability for deficient prospectus information is very wide and has led to disparate liability regimes.[255] From the perspective of market participants, the report resolves that "in case of cross-border transactions, the diversity in the different jurisdictions could make it difficult for market participants to assess their risks and rights in accordance with the applicable prospectus liability regimes".[256]

c. Conclusion: the (limited) impact of the EU capital market legislation on the national liability regimes

70. Even though the effect of EU capital market legislation on the Member States' national private laws has remained fairly limited, some impact has nonetheless been felt. For instance, the obligation to apply national civil liability rules to violations of the Prospectus Directive, the Transparency Directive and the CRA Regulation, has caused certain Member States to adjust their national laws and/or introduce (new) national liability rules.[257] Second, the introduction of harmonized regulatory standards regarding disclosure obligations, equal access to the market, information obligations, conduct of business rules etc., may have a converging effect on the standards that should be met by market participants in the private law sphere too. More particularly, via the promulgation of (often detailed) sets of rules, EU capital law has contributed to the formation of a more detailed legal framework of harmonized regulatory standards that may also influence the assessment of what constitutes a 'wrongful act' in the context of liability claims.[258] Furthermore, it was also noted that the AIFMD and

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[254] The request was made in the context of Directive 2010/73/EU of the European parliament and of the council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, *OJ* 2010 L 327/6. Rec. (12) of the directive particularly states that "[L]iability regimes in the Member States are significantly different due to national competence in civil law. In order to identify and monitor the arrangements in the Member States, the Commission should establish a comparative table of Member States' regimes."

[255] ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619, 30 May 2013, http://www.esma.europa.eu/, 27.

[256] *Ibid.*, 27.

[257] In response to the enactment of the Transparency Directive for example, the UK introduced a new s.90A FSMA, which provides for a statutory liability regime for secondary market information. see: P. DAVIES, 'Davies review of issuer liability. Liability for misstatements to the market: a discussion paper by Professor Paul Davies', 2007, available at: http://www.treasurers.org/node/3258, para. 40 ff.; with regard to Spain: SEBASTIÁN and TORTUERO, 'Prospectus liability under the Spanish Securities Market Act: a comparison between the New Spanish Regime and the US regime', 331; VEIL (ed.), *European capital markets law*, 264-265. The enactment of the Prospectus Directive prompted the reform of the national prospectus laws in Spain, including prospectus liability. The enactment of the CRA Regulation on the other hand caused the UK to enact new legislative rules on the liability of credit rating agencies. See in this regard also further below, Part I, Chapter III, para. 191.

[258] M. TISON and F. RAVELINGIEN, 'Roma Locuta, Causa Finita? Conflictenrechtelijke capita selecta inzake bancaire aansprakelijkheid na de Rome II-Verordering', J. ERAUW and P. TAELMAN, *Nieuw internationaal privaatrecht: meer Europees, meer globaal*, Mechelen, Kluwer, 2009, 246; M. TISON, 'De bescherming van de belegger in het kapitaalmarktrecht: de hobbelige weg naar een Europees ius commune', *Synthèses de droit bancaire et financier: liber amicorum André Bruyneel*, Brussel, Bruylant, 2008, 27, para. 20. See for this conclusion specifically with regard to the MiFID regulation: KRUITHOF, 'A different approach', 160 ("While the normative content of the behavioral standards can in

the UCITS IV-proposal contain more detailed liability rules and impose strict liability on depositaries when the conditions set out in the directives to that end are met.

Besides a potentially converging effect with regard to the standard of fault and the detailed rules in the AIFMD, however, EU capital market law has left matters of private enforcement and civil liability for violations of (EU originated) capital market law more or less entirely to the Member States' discretion.[259] Yet, some commentators took another point of view and asserted that with regard to MiFID, courts are precluded from subjecting private parties to stricter or otherwise different private law standards than the harmonized supervisory rules of conduct laid down in MiFID.[260] This contention has been supported by the argument that MiFID seeks to establish a level playing field in the area of investment services through maximum harmonization of the rules and does not allow for deviations in public and in private law as a result.[261] This contention fails to convince, however. It seems highly unlikely and incorrect to state that merely because MiFID aims to establish a level playing field for investment services, this also implies that the supervisory standards laid down in MiFID suddenly and entirely replace the gradually developed bodies of national private law, without any explicit reference to an intended private law effect in MiFID itself.[262] Moreover, it is repeated that the Commission made an (unsuccessful) attempt to introduce harmonized liability rules for investment firms in its consultation document for the revision of MiFID, which confirms that liability for violation of the MiFID rules of conduct is not harmonized by EU law at this point in time.[263]

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effect be harmonized through the reflective effect of supervisory conduct of business rules recognized in national law, the same is not true at all for the rules on causation and remedies."); see in this regard also: M. KRUITHOF, 'De privaatrechtelijke werking van de MiFID 2004-gedragsregels: een analyse van de mate waarin zij de wederzijdse rechten en plichten van dienstverlener en cliënt kunnen aanvullen en beperken', IFR, *Financiële regulering in de kering*, vol. 14, Antwerpen-Cambridge, Intersentia, 2012, 309; V. COLAERT, 'De meerlagige rechtsverhouding financiële dienstverlener - belegger', *RW* 2011, nr. 19, 858; E. VANDENDRIESSCHE, 'Causaliteit en bewijslast in het Belgische financiële aansprakelijkheidsrecht bij beleggingsdienstverlening', D. BUSCH and C.M.J. KLAASSEN, *Aansprakelijkheid in de financiële sector*, Hoofdstuk 5, Deventer, Kluwer, 2013, 180-183; V. COLAERT, 'Financiële diensten en de Wet Marktpraktijken. Enkele knelpunten', in Instituut Financieel Recht, *Financiële regulering in de kering*, Antwerpen, Intersentia, 2012, 248-249. On the interplay between MiFID and contract law in general: S. GRUNDMANN and J. HOLLERING, 'EC Financial Services and Contract Law – Developments 2005–2007', 4 *ERCL*, 2008, 62-64. See for a similar reasoning in a more general context: CAFAGGI, 'A coordinated approach', 205 ff. "standard setting is the institutional activity through which levels (quantitative aspect) and types (qualitative aspect) of conduct of those causing injury and their victims are determined").

[259] As noted, the CRA Regulation explicitly defers to national liability laws for the interpretation of the notions 'gross negligence', 'intent', 'causation' etc. See: art. 35a (4) CRA Regulation and *supra*, para. 64.

[260] See for instance: D. BUSCH, 'Why MiFID matters to private law', *C.M.L.J.*, 2012, 10 (arguing that national courts should not subject asset managers to private law duties that are stricter than the public law duties contained in MiFID); in a similar sense: COLAERT, 'De meerlagige rechtsverhouding', 855 (asserting that MiFID has harmonized not only the rules of conduct as *supervisory standards*, but as *private law standards* in the context of liability for investment services (emphasis added). As a consequence, courts cannot set different standards than those laid down in MiFID, according to the author).

[261] Idem.

[262] Extensively on the impact of MiFID on national private law: KRUITHOF, 'Privaatrechtelijke werking', 325 ff. See also: CHEREDNYCHENKO, 'European securities regulation', 945; M. TISON, 'The civil law effects of MiFID in a comparative law perspective', S. GRUNDMANN, B. HAAR and H. MERKT, *Festschrift für Klaus J. Hopt Zum 70. Geburtstag Am 24. August 2010: Unternehmen, Markt Und Verantwortung*, Band 2, Berlin, New York, De Gruyter, 2010, 2633 (submitting that the MiFID-public law duties do not preclude the national courts from setting stricter standards in a private law context); CHEREDNYCHENKO, 'Regulation of Retail Investment Services', 421; for a German perspective: REICH, 'Interrelation between rights and duties in EU law', 155 ff.

[263] "While investment firms are subject to possible administrative sanctions by the competent authorities if they infringe MiFID rules, the directive does not deal with the liability of firms towards clients in cases where infringement of MiFID rules causes damage. Thus, the conditions for such civil liability vary according to Member States' civil legal orders and may sometimes be difficult to establish." And "Such a principle, could be included in the framework directive and would enable clients to claim damages against investment firms infringing MiFID rules, particularly in areas concerning the relationship between firms and clients and where specific obligations towards the client are foreseen. The following areas could be covered: information requirements, suitability and appropriateness test, reporting requirements, best execution and client order handling." European Commission, Public consultation: Review of the Markets in Financial Instruments Directive

Furthermore, EU capital market law has also left considerable room for national differences with regard to other requirements and elements of liability claims, such as the standard of liability (e.g. strict liability compared to negligence or intentional wrongful behavior) and different interpretations of these concepts and requirements.[264] For example, elements such as causation and recoverable loss, the measurement of damages and the question whether a claim is contractual or non-contractual in nature, are generally not dealt with in the European legislation and have been left to the discretion of the Member States.[265] Finally, the differences in national liability rules in the area of capital market law have also been clearly illustrated in the report on the duties and liabilities of depositaries under UCITS on the one hand, and the ESMA report on national prospectus liability regimes on the other hand.[266] Drawing on these considerations and findings, it seems fair to conclude that (so far) EU capital market law has affected the national liability laws to a limited extent, yet seeks to increase its influence and impact, as illustrated in more recent legislative initiatives. This observation brings up the question whether and to what extent the EU is authorized to regulate and harmonize national liability law and whether a potential lack of competence may explain the restraint exercised by the EU level with regard to the private enforcement of EU capital market law.

2. The division of powers justifying the absence of civil liability law in the EU capital market law directives?

a. Division of powers between the EU and the Member States: overview

71. According to art. 5 (1) and 4 (1) TEU, the powers of the Union are confined to those conferred upon it. In other words, only to the extent the EU has been attributed the power to regulate civil liability or (private) enforcement matters, such rules can be legitimately enacted at the EU level. As the EU treaties do not contain an explicit reference to the EU's lawmaking powers in terms of civil liability rules, or even broader, matters of private law, other legal bases may accommodate EU rules touching upon civil liability rules. With respect to broad and general legal grounds for the enactment of EU law for instance, reference can be made to art. 114 and art. 26 TFEU that allow for the adoption of measures for the approximation of national laws to promote the establishment and functioning of the internal market.[267] The broad wordings used in art. 114 TFEU leave considerable room for interpretation and lend itself for frequent and extensive use by the European institutions in various fields of law, including EU capital market law and consumer law.[268] In the context of consumer law

(MiFID), 2010, 8 December, ec.europa.eu, 63, para. 7.2.6. *Supra*, para. 66. See also: KRUITHOF, 'Privaatrechtelijke werking', 307 and 341 ff., stating that the MiFID rules of conduct are too general, i.e. not detailed enough, to regulate all aspects of the obligations that apply with regard to the provision of finanical services and that may give rise to liability in case of violations.

[264] See for instance the differences reported with regard to liability rules applicable to UCITS depositaries and the differences in national prospectus liability regimes: CESR, Mapping of duties and liabilities of UCITS depositaries; ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619.

[265] See also: KRUITHOF, 'A different approach', 162; TISON and RAVELINGIEN, 'Roma Locuta', 246.

[266] The mapping exercise was conducted by CESR (now ESMA) and was initiated after the *Madoff*-scandal, as investors in various Member States tried to recover the losses incurred and encountered widely divergent liability rules depending on which national law applied. CESR, Mapping of duties and liabilities of UCITS depositaries, 121. See in this regard also the pending UCITS-V-Proposal, discussing the implications of the differing national liability rules. With regard to the ESMA-report: ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619, concluding that there are substantial differences between the national prospectus liability regimes (p.27).

[267] More extensively: P. CRAIG and G. DE BÚRCA, *EU law: text, cases, and materials*, Oxford, OUP, 2011, 92 ff.

[268] Recent legislation that contained rules involving civil liability law, such as the CRA Regulation and the PRIPS-proposal, as well as less recent directives, such as the Prospectus and the Transparency Directive, refer to art. 114 TFEU (or the former art. 95 EC) as the legal basis for the adoption of legislation in furtherance of the establishment and functioning of the internal

for instance, the harmonization of liability rules for defective products has been deemed necessary because diverging liability rules would distort competition and preclude the free movement of goods while also leading to different degrees of consumer protection in the common market.[269] Art. 114 TFEU has also been used as a legal basis for the recent proposal for a directive to facilitate damages under national law for infringements of EU competition law.[270] The proposal aims to harmonize and approximate both substantive and procedural national rules and intends to provide for a nonbinding guidance on the quantification of antitrust harm.[271] Besides the harmonization of laws, free movement of goods or services and the right to free establishment can be employed as legal basis to enact EU law with private law effects too, whereas with regard to consumer law, art. 169 (2) (b) TFEU provides a legal basis for measures that support, supplement and monitor the policy pursued by the Member States in order to promote consumer interests and to ensure a high level of consumer protection.[272] Additionally, the Treaty of Amsterdam introduced an explicit basis for the harmonization of civil procedural law, provided it concerns matters with cross border implications.[273] The latter only applies to the extent it concerns *procedural* issues, however, including conflict of laws and jurisdiction matters as listed and clarified in article 81 TFEU, yet no similar provision was enacted with regard to *substantive* civil law.

72. Summarized, the broadest and most frequently used legal basis to enact civil liability rules thus lies with article 114 TFEU, as illustrated by recurrent references in EU capital market law and recent legislative initiatives.[274] Art. 114 TFEU constitutes a functional lawmaking power, as it legitimates the enactment of rules only in function of the enhancement of the establishment and

market. With regard to consumer law, reference can be made to the Product Liability Directive, one of the first directives that introduced European liability rules: Council Directive 85/374/EEC of 25 July 1985, on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products, *OJ* L 210/29 (Product Liability Directive). The directive refers to art. 100 EEC, currently art. 114 TFEU. See in this regard also: G. HOWELLS and M. PILGERSTORFER, 'Product Liability', C. TWIGG-FLESNER, *The Cambridge Companion to European Private Law*, Cambridge, Cambridge University Press, 2010, 257. Other examples of European rules touching upon civil liability law in the context of consumer law include Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, *OJ* L 171/12 (Consumer Sales Directive) and Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours, *OJ* L 158/59 (Package Travel Directive).

[269] Rec. (1) Product Liability Directive.

[270] Proposal for a Directive of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union, COM(2013) 404 final, Strasbourg, http://eur-lex.europa.eu. See on the proposal more extensively: B.J. DRIJBER, 'Het Richtlijnvoorstel over schadevorderingen wegens mededingingsinbreuken', *Ondernemingsrecht* 2013, 489.

[271] Proposal for a Directive of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union, COM(2013) 404 final, Strasbourg, http://eur-lex.europa.eu, 18.

[272] S. WEATHERILL, 'Competence and European Private Law', C. TWIGG-FLESNER, *The Cambridge Companion to European Private Law*, Cambridge, Cambridge University Press, 2010, 58.

[273] Art. 81 TFEU.

[274] The CRA Regulation, the Prospectus Directive, the Transparency Directive and the PRIPS-proposal to article 114 TFEU as the legal basis. With regard to the Prips-proposal it has been noted that the proposed liability rules appear more far reaching than those in the context of the proposal regarding credit rating agencies. Not only contains the proposal a suggested (substantive) liability rule, it also suggest to introduce rules concerning the procedural aspects of civil liability claims following violations. It is more particularly suggested to introduce a reversal of the burden of proof regarding the correctness of the information contained in the key information document (art. 11 (2) and rec. (17)). Furthermore, the proposal also suggests leaving the burden of proof regarding the requirement of causation in civil procedures on the investor-claimant (rec. (17)). See: European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012/0169, 352 final, Brussels, 3 July 2012, available at http://eur-lex.europa.eu.

functioning of the internal market.[275] Besides the functionality requirement, other limits confine the legal basis provided for in art. 114 TFEU too, since it concerns a lawmaking power that was not been exclusively conferred on the EU, but instead shared between the EU and the Member States. As a result, some fundamental principles governing the division of powers in case of competences shared between the EU and national level must be taken into account as well.[276] These principles, being the principle of subsidiarity and proportionality, more particularly determine when the EU level should exercise the shared competences, and when the execution of powers should be left to the Member States.

b. Principles of subsidiarity and proportionality

73. Whether the European legislator can draw on article 114 TFEU as a legal foundation to enact law should be considered in the light of the principles of subsidiarity and proportionality that apply in those cases where competences have not been exclusively conferred on the EU but shared with the Member States. According to the principle of subsidiarity, the European legislator is to abstain from regulating matters unless the matter cannot be dealt with more efficiently on the national level.[277] In other words, to the extent the Member States are considered the best placed authority to organize enforcement – and effectively do so – the EU level should not interfere even though it has been conferred with the (shared) competence to do so. To assess whether or not the principle of subsidiarity is respected, the EU is obliged to provide a detailed statement appraising the application of subsidiarity and proportionality in proposed legislation.[278] Member states also can bring alleged infringements before the ECJ, according to art. 263 TFEU.

74. The principle of proportionality on the other hand holds that the content and form of the actions undertaken by the EU should be limited to what is needed to achieve the goals set.[279] To the extent objectives can be realized with means with a lesser impact on the national legal frameworks, the latter is preferable above those means interfering to a larger extent. Both the principle of proportionality and subsidiarity thus aim to prevent the unlimited use of legislative power at the EU level to the detriment of the Member States.

c. Reluctance and restraint vis-à-vis the 'Europeanization' of private law

75. The analysis allows for the conclusion that the EU level has been attributed a broad, if functional, lawmaking competence in furtherance of the internal market and may enact civil liability rules within the limits of that power, insofar the principles of subsidiarity and proportionality are taken into account. Notwithstanding these broad powers, however, the EU legislator has moved rather

[275] WEATHERILL, 'Competence and European Private Law', 58; D. CARUSO, 'The Missing View of the Cathedral: The Private Law Paradigm of European Legal Integration', 3 *ELJ*, 1997, 11.

[276] See on shared EU competences more extensively: CRAIG and DE BÚRCA, *EU Law*, 83.

[277] Art. 5 (3) TEU. See on the principle of subsidiarity: WEATHERILL, 'Competence and European Private Law', 65; CRAIG and DE BÚRCA, *EU Law*, 94-100; T. TRIDIMAS, *The General Principles of EU Law*, Second Edition, Oxford, Oxford University Press, 2006, 183 ff. The application of the principle of subsidiarity is also set out in details in protocols attached to the Lisbon Treaty (Protocol (No 1) On the Role of National Parliaments in the European Union; Protocol (No 2) On the Application of the Principles of Subsidiary and Proportionality).

[278] Art. 5 Protocol (No 1) On the Role of National Parliaments in the European Union.

[279] Art. 5 TEU. The criteria for applying the principle are set out in the Protocol (No 2) on the application of the principles of subsidiarity and proportionality. See in this regard also: CRAIG and DE BÚRCA, *EU Law*, 168; O. REMIEN, 'Principle of proportionality', J. BASEDOW, K.J. HOPT and R. ZIMMERMANN, *The Max Planck Encyclopedia of Private Law*, Vol. II, Oxford, Oxford University Press, 2012, 1321; TRIDIMAS, *General Principles*, 136.

cautious and restrained when it comes to civil liability rules as a means to enforce EU capital market law and/or remove potential national barriers that may cause differing degrees of investor protection across Member States. The question hence arises why there is such restraint in employing civil liability as enforcement mechanism and why proposals to introduce harmonized liability rules – as in the context of MiFID and Prospectus Directive revision – have recurrently failed.

76. One of the most frequently cited answers to this question relates to concerns voiced on the national level that the harmonization process of liability law at the EU level would require the EU legislator to find common ground in the wide variety of substantially diverging national laws. It is particularly asserted that this would cause the EU level to overlook specific characteristics of the various national liability laws, either because of unawareness of national sensitivities and preferences, or simply because of choices that would have to be made in the harmonization process.[280] It is therefore feared that the creation of common EU liability rules would inevitably distort the balance and coherence inherent to national private laws, as these laws have been developed by the national courts over time via gradual assessment and interpretation in a wide variation of concrete cases.[281] Even if EU liability rules would be limited in scope to financial law matters, a spillover effect affecting national liability systems appears almost inevitable.[282] The impact of European liability rules – even when promulgated with a limited scope – would therefore affect the domestic system, including the national legal doctrines, interpretation methods and tools, which causes 'doctrinal discomfort' as CARUSO points out, and incites opposition on the national level.[283]

77. However, the fear for spillover effects distorting the balance and coherence of the national private laws seems hardly the only reason for the restraint and reluctance displayed by both the Commission and the Member States relating to the introduction of harmonized liability rules.[284] Over time, various explanations and objections have been formulated, stimulating the debate on the potential reach of what has been termed the 'Europeanization' of private law.[285] One stream of arguments states that similar to language and culture, private law is the product of national tradition and identity.[286] Harmonizing national private laws is hence considered to erase (part of) the cultural heritage of the Member States, and therefore resisted by these scholars. Yet others have indicated that what is really at stake lies with the fact that European rules impacting national private laws are likely

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280 TISON, 'Civil law effects', 2622; HELLGARDT, 'Europarechtliche Vorgaben', 155 and references cited in ftn. 13; see on the perceived prerogative of the Member States with respect to private law also: J. BASEDOW, 'The Gradual Emergence of European Private Law', 1 *ALR*, 2004, No. 1, 1-18.

281 CARUSO, 'The Missing View of the Cathedral', 28; M. CLAES, 'The European Union, its Member States and their Citizens', D. LECZYKIEWICZ and S. WEATHERILL, *Involvement of EU law in private law relationships*, Oxford, Portland, Hart Publishing, 2013, 37; TISON, 'Civil law effects', 2622; N. MOLONEY, 'Liability of asset managers: a comment', 7 *C.M.L.J.*, 2012, nr. 4 (414) 421.

282 See in this regard also: V. MILUTINOVIC, *The 'Right to Damages' under EU Competition Law* Alphen aan den Rijn, Kluwer, 2010, 335 ff.

283 CARUSO, 'The Missing View of the Cathedral', 28. The reluctance displayed by the Member States when it concerns coordination or harmonization efforts with regard to private liability initiated at the EU level is also mentioned in SCHAMMO, *EU Prospectus Law*, 241; TISON, 'Civil law effects', 2623.

284 For a concise overview of the literature formulating objections against the impact of EU law on national private law: CLAES, 'The European Union', 37-38, and reference cited.

285 The literature regarding the 'Europeanization' of private law is not limited to civil liability law but spans the entire scope of private law, including contract law, tort law and so on. See in this regard for instance: REICH, 'Interrelation between rights and duties in EU law', 112.

286 E. DE BOER, 'The relation between uniform substantive law and private international law', A.S HARTKAMP, *Towards a European civil code*, Nijmegen, Ars Aequilibri, 1994, 51; H. COLLINS, 'European Private Law and the Cultural Identity of States', 3 *ERPL*, 1995, 353.

to imply policy choices.[287] Surrendering private law to the EU therefore implies changes in the national legal doctrines not only in legal-technical terms, but also in terms of policy and national sovereignty.[288]

78. The combination of the functional competence of the EU to enact civil liability rules when justified in the light of necessity for the internal market and the reluctance of the Member States to transfer what is considered a national prerogative may explain the fragmented existence of civil liability in the various areas of EU law. More particularly, in some areas of law, civil liability rules seem to have been more easily accepted than in others. In the context of consumer law for instance, various examples of the impact of EU law on national civil liability law can be found, whereas in other areas private law obligations are conspicuous by their absence. It has been pointed out that in case highly similar doctrines or rules exist on the national level, consensus on harmonized rules may be easier to reach, while circumstances in which it is felt that new regulation is needed in the Member States may also contribute to consensus.[289] However, in cases where national rules already exist or where case law has developed accepted and longstanding principles, it may well be that consensus on harmonized liability rules – that would require Member States to change their laws – is politically unfeasible because of the aforementioned reasons.[290]

d. Conclusion: broad yet functional EU lawmaking powers

79. Although it has been established that the EU level has been attributed with broad, functional lawmaking competences to promote the internal market, provided that the principles of subsidiarity and proportionality are respected, the EU legislator has not invariably been able to put these powers to full use with regard to the introduction of harmonized liability rules. The reason for caution on the side of the EU and opposition on the side of the Member States seems to relate to matters of sovereignty, tradition, political power, and fear for spillover effects that would distort the balance and coherence of the national private laws. However, scholarship debating the impact of enforcement practices on market development and the widespread feeling that the financial crisis demonstrated weaknesses related to law enforcement have drawn attention and interest at the EU level as to what role private enforcement may play in the integration process and how harmonized liability rules may contribute to EU market integration. Finding that the European legislative level, and the Commission in particular, have not always prevailed in attempts to harmonize civil liability rules (in the field of EU capital market law and beyond), attention has increasingly turned to the role the Court of Justice of the EU (ECJ) is playing in this debate. In the field of EU competition law in particular, private party liability for breaches of EU law was indeed not introduced by legislative reforms but instead developed by the ECJ via its supervising and coordinating role to ensure a uniform and coherent interpretation of EU law in national courts. The evolutions taking place in the EU courts in various fields of law also bring

[287] CARUSO, 'The Missing View of the Cathedral', 29.

[288] "Harmonization, however, has progressively driven home to the Member States how much of their sovereignty is at stake in the surrendering of national control over private law." CARUSO, 'The Missing View of the Cathedral', 29.

[289] *Ibid.*, 11. For instance with regard to the CRA Regulation, it may be derived from the summarized document on the responses that the Commission received to its public consultation on the proposal to, amongst other things, impose civil liability to credit rating agencies, that Member States and other market participants (with the exception of the credit rating agencies themselves) seemed to welcome the suggestion. The fact that many Member States did not have specific liability rules nor a tradition of credit rating agency liability may have contributed to their willinges to introduces these rules. See: Overview of responses to Public Consultation on Credit Rating Agencies, available at: http://ec.europa.eu/internal_market/securities, p. 3.

[290] See for instance the proposals to introduce (harmonized) liability rules in the Prospectus Directive or MiFID (*supra*).

about the question to what extent the ECJ case law may impact matters of private enforcement of EU capital market law.

B. Private enforcement of investor protection measures: the role of the EU courts

1. Enforcement of EU law: the role of the ECJ and ECFI

80. As demonstrated, EU capital market law is deeply concerned with investor protection and has promulgated an extensive set of obligations imposed on a wide range of market participants, regulated the issuance and supply chain of financial instruments and products from top to bottom. The EU legislator did however not elaborate the means investors have at their disposal to enforce rights conferred on them by EU law however, and has not engaged deeply in harmonizing private enforcement mechanisms so far. Yet the question has been asked to what extent these EU rights are enforceable by investors themselves and whether national law is required to provide for remedies in case EU law has been violated. We set out with the outlines of the decentralized system of EU law enforcement, discuss the role the ECJ plays in this regard and examine the interaction between EU law and national liability law.

a. Decentralized system of EU law enforcement

81. Liability of EU institutions – Action for damages or indemnity. – In its seminal landmark case *Van Gend en Loos*, the ECJ stressed that EU law not only imposes obligations on individuals but also grants them rights.[291] The enforcement of those rights however is generally not dealt with at the EU level, especially since access to the EU courts for claims filed by private parties is restricted. Only in case it concerns a complaint following alleged unlawful behavior of the EU institutions, private parties are granted direct access to the EU courts to bring an action for damages.[292] Both contractual and non-contractual liability cases can be brought against the EU institutions. Contractual liability of the Union is governed by the national law governing the contract. Actions for damages or indemnity against the Union on the other hand are governed by the 'general principles common to the laws of the Member States'.[293] As a result, the court considers the imposition of (non-contractual) liability subject to three requirements, being wrongful conduct, causation and loss.[294]

[291] ECJ, Case 26-62, 5 February 1963, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*, [1963], ECR 00001.

[292] Liability of the EU institutions is laid down in art. 268 and 340 TFEU (former art. 235 and 288(2) TEC). More extensively: D. EDWARD and R. LANE, *European Union Law*, Cheltenham, Edward Elgar, 2013, 229 ff.

[293] Art. 340 TFEU.

[294] See for instance Case T-170/00 *Förde-Reederei GmbH* v *Council and Commission* [2002] ECR II-515, para 31; Case 26/81 *Oleifici Mediterranei* v *EEC* [1982] ECR 3057, para 16; Case C-348/06P *Commission v Girardot* [2008] ECR I-833, para 52; Case T-406/06 *Evropaïki Dynamiki* v *Commission*, [2008] ECR II-247, para 133; Case T-91/05 *Sinara Handel GmbH* v *Council and Commission* [2007] ECR II-245, para 87; Case T-149/96 *Confederazione Nazionale Coltivatori Diretti (Coldiretti)* [1998] ECR II-3841, para. 101; Case T-175/94 *International Procurement Services* v *Commission* [1996] ECR II-729, para 44; Case T-336/94, *Efisol* v *Commission* [1996] ECR II-1343, para 30; Joined Cases C-120/06 P and C-121/06, P, *FIAMM and FIAMM Technologies v Council and* Others [2008] ECR I-6513, para 106; Case T-267/94, *Oleifici Italiani* v *Commission* [1997] ECR II-1239, para. 20; Case T-113/96 *Dubois et Fils* v *Council and Commission* [1998] ECR II-125, para 54; Case C-146/91 *KYDEP* v *Council and Commission* [1994] ECR I-4199, para 81; Case 111/86 *Delauche* v *Commission* [1987] ECR 5345, para. 30; Case T-383/00 *Beamglow* v *Parliament and Others* [2005] ECR II-5459, para. 95; Case C-136/92 P *Commission* v *Brazzelli Lualdi and Other* [1994] ECR I-1981 para 42; Case T-19/07 *Systran and Systran Luxembourg v Commission* [2010] ECR para 126*;* Joined cases T-79/96, T-260/97, T-117/98 *Camar Sri and Tico Sri* v *Commission* [2000] ECR 11-2193, para 181, 204, 216; Case C-259/96 P *Council* v *De Nil and Impens*, [1998] ECR I-2915,

82. **Member state liability.** – Claims pursuant to alleged infringements by Member States on the other hand can be brought by either the Commission or another Member State.[295] Private parties can do as much as signal matters or problems to the Commission, but they are barred from filing claim in EU courts themselves and bound to respect the Commission's discretionary decision whether or not to bring the case.[296] In the event where a case against a Member State for non-compliance with its EU duties is brought before the EU courts, three conditions must be met. First, the infringed European rule must be intended to confer individual rights to the claimant. Second, the breach must be 'sufficiently serious' and third, a causal link between the breach and the alleged loss must be proven.[297] In its assessment though, the role of the European court is traditionally limited to the assessment of the first two requirements, leaving the examination of the required causal nexus, the recoverable loss and remedies to the national courts.[298] This method implies that in case an infringement is found by the ECJ, it is still left to the national courts to remedy the breach in case aggrieved parties bring a claim in this regard. Since *Francovich*, private parties suffering harm as a result of incomplete, improper or untimely transposition of EU law intended to confer rights on individuals, have a right to reparation in the national courts.[299]

83. **Private party liability for breaches of EU law.** – Access for private parties to the EU courts is restricted to the circumstances described in the preceding paragraphs. Only to the extent European institutions allegedly violated EU law, private parties can bring their claim before an EU court, whereas in cases of member state liability, private parties can only bring their complaints under the attention of the Commission and turn to the national courts to demand relief. Claims for breaches of EU law directed against other private parties are invariably brought before national courts.

84. **Conclusion.** – Overall, mechanisms centralized at the EU level to enforce EU law are limited in scope and access vis-à-vis the citizens it often aims to protect. Private parties protected by rights conferred on them by EU law generally have to rely on the domestic courts in order enforce them.[300] Acknowledging the disconnection that flows from this system of creating rights and rules at the EU level without control on the enforcement of the accompanying duties though, the ECJ stepped in and

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para 23. See also: A. BIONDI and M. FARLEY, *The right to damages in the European law*, Alphen aan den Rijn, Kluwer Law International, 2009, 138 ff.

[295] As Member States usually tend to avoid initiating proceedings against other Member States to preserve diplomatic relations, this right will seldom be exercised by Member States (J. BASEDOW, 'The Judge's Role in European Integration', H.-W. MICKLITZ and B. DE WITTE, *'The European Court of Justice and the Autonomy of the Member States'*, Cambridge, Intersentia, 2012, 70).

[296] Art. 258 TFEU (former art. 226 TEC). According to art. 259 TFEU, other Member States, after having brought the matter before the Commission, can also file claim against an allegedly defaulting Member State. See extensively: S. ANDERSEN, *The Enforcement of EU law. The Role of the European Commission*, Oxford, Oxford University Press, 2012, 44 ff.

[297] Joined cases C-6 and C9/90, *Francovich and Others* v *Italy* [1991] ECR I-5357, para. 39-40. See also: CRAIG and DE BÚRCA, *EU Law*, 247.

[298] See for instance amongst many others: joined cases C-295/04 and C-298/04 *Manfredi* [2006] ECR I-6619; Case C-127/95, *Norbrook Laboratories* [1998] ECR I-1531, para. 110; Case 33/76 *Rewe-Zentralfinanz eG et Rewe-Zentral AG v Landwirtschaftskammer für das Saarland* [1976] ECR 01989; Case C-91/92 *Paola Faccini Dori v Recreb Srl*, [1994] ECR I-3325, para. 29; Case 453/99 *Courage* v *Crehan* [2001] ECR I-6297; Joined cases C-295/04 and C-298/04 *Manfredi* [2006] ECR I-6619. See also: M. DOUGAN, *National remedies before the court of justice*, Oxford, Hart Publishing, 2004, 18 ff. CRAIG and DE BÚRCA, *EU Law*, 251.

[299] Joined cases C-6 and C9/90, *Francovich and Others* v *Italy* [1991] ECR I-5357. See in this regard also: EDWARD and LANE, *European Union Law*, 321, para. 6.35 ff.

[300] See also: *Ibid.*, 312, para. 6.27; CRAIG and DE BÚRCA, *EU Law*, 218; R. SCHULZE, 'Contours of European Private Law', R. SCHULZE and H. SCHULTE-NÖLKE, *European Private Law - Current status and perspectives*, Munich Sellier, 2011, 19; REICH refers to the division between the enactment and the enforcement of rules as the 'hybridization of remedies', see: REICH, 'Social, Political and Cultural Dimension', 81; for a comprehensive and instructive study on this topic, consult: DOUGAN, *National remedies*, 418p.

developed various instruments and techniques to monitor and coordinate the enforcement of EU law on the national level.

b. Role of the EU courts in centralizing EU law enforcement

85. In structuring the EU framework, the ECJ was awarded the task to advise national courts on the correct application of EU law through the preliminary reference procedure that allows the national courts to defer questions of EU law to the ECJ.[301] The procedure is not designed to have the ECJ decide on national matters and cases, but to interpret and answer questions on EU law to enable and guarantee a uniform application and interpretation of EU law in the Member States. Throughout its rulings, the ECJ has developed a tool box with a range of instruments and doctrines designed to effectively monitor the (uniform) application of EU law. Notable examples are the (widely expanded) doctrine of direct effect, the principle of EU primacy, the principles of effectiveness ('*effet utile*'), equivalence and proportionality, the effective judicial protection of EU law with regard to remedies and procedures available to remedy breaches of EU law.[302]

i) Enforcement of EU law in national courts

86. Direct effect. – Various doctrines and principles have been developed by the ECJ to govern the effect and application of EU law in the national legal order. According to the principle of primacy for instance, national law incompatible with EU law must be disregarded as the latter principally prevails.[303] The doctrine of direct effect on the other hand implies that provisions laid down in EU law that are unconditional, precise and sufficiently clear can be relied on by individuals and directly invoked in national courts.[304] The doctrine of direct effect has become one of the most important techniques established and developed by the ECJ to allow European law to take effect in national legal orders. Whether EU law has direct effect in national courts is conditional upon whether the provisions (i) are clear and precise, (ii) create unconditional and unqualified obligations, and (iii) require no further implementing measures on the part of an EU or national authority.[305] To the extent these conditions are met, individuals can enforce EU law in domestic courts against either public bodies of the Member States and/or private parties, depending on whether or not the direct effect of the rules has been limited to public bodies of the Member States or not. The possibility to invoke EU law against the state is referred to as vertical liability, whereas reliance on EU provisions in a procedure directed against a private party is considered horizontal direct effect. As is well established in EU law, directives as opposed to regulations, lack direct horizontal effect and are limited to vertical direct

[301] Art. 19 (3) (b) TEU; art. 267 TFEU (former art. 234 TEC).

[302] On the role of the ECJ in the enforcement of EU law, see also: A. JOHNSTON and H. UNBERATH, 'European private law by directives: approach and challenges, *Cambridge Companion to European Union Private Law*, Cambridge, Cambridge University Press, 2010(85) 97-98; DOUGAN, *National remedies*, 2 ff.; A. ARNULL, *The European Union and its Court of Justice*, Oxford, OUP, 2006, 267.

[303] Case 6-64 *Costa v Enel* [1964] ECR 1203. See on primacy: EDWARD and LANE, *European Union Law*, 297, para. 6.16; CRAIG and DE BÚRCA, *EU Law*, 256.

[304] ECJ, Case 26-62, 5 February 1963, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*, [1963], ECR 1; Case 41-74 Yvonne van Duyn v Home Office [1974] ECR 1337; Case 43/75 Defrenne v Société Anonyme Belge de Navigation Aérienne [1976] ECR 455. See also: CRAIG and DE BÚRCA, *EU Law*, 180 ff.; EDWARD and LANE, *European Union Law*, 293, para. 6.13.

[305] ECJ, Case 26-62, 5 February 1963, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*, [1963], ECR 1; Case 41-74 *Yvonne van Duyn v Home Office* [1974] ECR 1337; Case 148/78 *Publicco Ministero v Ratti* [1979] ECR 1629. EDWARD and LANE, *European Union Law*, 294 ff.; CRAIG and DE BÚRCA, *EU Law*, 180.

effect, meaning that they do not provide for a legal basis for civil liability for allegedly aggrieved parties vis-à-vis other private parties but only against the state for not correctly or timely implementing the directive.[306] As a result, Regulations can always be relied on in law disputes brought before national courts, regardless of whether the claim is directed against a public authority or a private party whereas directives can only be invoked against public authorities. In case courts would attach horizontal effect to directives, the founding treaties of the European Union would be violated for only regulations can enact obligations with immediate effect vis-à-vis private parties.[307]

Hence, private parties who should actually be bound by the provisions laid down in directives cannot be sued in national courts on the mere legal basis of a breach of an EU directive in other words. With regard to EU capital market law, this is not without relevance since most of the legislation has been enacted through directives so far. As directives lack horizontal direct effect, private parties are dependent on national legislation implementing the EU rules in order to invoke the rules against other private parties. Or this is at least the principle. Over time, the ECJ has expanded the reach of direct effect of directives considerably, for instance by establishing the concept of indirect effect and incidental effect.[308] Indirect effect obliges national courts to interpret national law as much as possible in the light of the wordings and purpose of directives, implying that directives still impact national law despite lacking horizontal effect.[309] Incidental effect on the other hand refers to the possibility that even though other private parties may not be sued for failure to comply with EU directives, they may feel mere adverse effects affecting their rights as a result of a claim based on a directive, as long as these effects vis-à-vis other private parties are merely incidental.[310] The ECJ's expanding view on the scope of the direct effect of directives has resulted in exceptions and relaxations of the principle that directives do not have a direct horizontal effect, calling for the conclusion that the matter of (private)

[306] The principle that directives lack horizontal direct effect has been criticized in the literature and – over time – considerably eroded and diluted. The broad and complex exceptions and sidestepping of the principle have even caused some to suggest the reconsider the principle for its complexity adds more to confusion than it assists in the creation of a harmonized internal market. See on this topic for an overview: CRAIG and DE BÚRCA, *EU Law*, 180-217; see also: S. PRECHAL, 'Does direct effect still matter', 37 *CMLRev*, 2000, 1049-1069; A. JOHNSTON and H. UNBERATH, 'Law at, to or from the Centre? The European Court of Justice and the Harmonization of Private Law in the European Union', F. CAFAGGI, *Institutional Framework of European Private Law*, New York, Oxford University Press, 2006, 158; S. WEATHERILL, *Cases and Materials on EU Law*, Oxford, Oxford University Press, 2012, 112; M. DOUGAN, 'The Disguised Vertical Direct Effect or Directives', 59 *Cambridge L.J.*, 2000, 586; J. STUYCK, 'The European Court of Justice as a motor of private law', C. TWIGG-FLESNER, *Cambridge Companion to European Union Private Law*, Cambridge, Cambridge University Press, 2010, 108.

[307] Art. 288 TFEU. See also: CRAIG and DE BÚRCA, *EU Law*, 105 ff. See also more extensively in this regard: P. CRAIG, 'The legal effect of directives: policy, rules and exceptions', 34 *ELR*, 2009, iss. 3, 349.

[308] Case C-201/02 *Wells* [2004] ECR I-723, para 56; Case C-194/94 *CIA Security International SA* v *Signalson SA and Securitel Sprl* [1996] ECR I-2201; see also: DOUGAN, 'The Disguised Vertical Direct Effect or Directives', 586-612; CRAIG, 'The legal effect of directives: policy, rules and exceptions', 364-369; CRAIG and DE BÚRCA, *EU Law*, 207 ff.; S. WEATHERILL, 'The elusive character of private autonomy in EU law', D. LECZYKIEWICZ and S. WEATHERILL, *Involvement of EU law in private law relationships*, Oxford, Portland, Hart Publishing, 2013, 17; WEATHERILL, *Cases and Materials on EU Law*, 122.

[309] Case C-14/83 *von Colson and Kamann* [1984] ECR I 1891, para. 26. See in this regard also: JOHNSTON and UNBERATH, 'Law at, to or from the Centre?', 163.

[310] Or as the court explained: "mere adverse repercussions on the rights of third [private] parties […] do not justify preventing an individual from invoking the provisions of a directive […]". Directives can still not be relied on by private parties to impose obligations derived from EU directives vis-à-vis other private parties, yet in case a private party enforces its rights derived from directives against a public authority and causes another third party to feel adverse effects of that action, this is permitted as a matter of EU law. In this case, a private party called for the withdrawal for mining activity that violated EU environmental law. The claim was directed against the state authority that issued the permit, yet in case it would be withdrawn, the mining company that would no longer be authorized to conduct its mining activities would obviously feel the effects. This was not considered a problem however, since it was a mere "incidental" effect of the claim directed against the public authority. Case C-201/02 *Wells* [2004] ECR I-723, para 56.

EU law enforcement is a gradually unfolding story with increasing possibilities for private parties to enforce EU law in national courts, including rights granted vis-à-vis other private parties.[311]

87. Other techniques broadening the impact of directives include a flexible interpretation of the term 'national authority' in the context of vertical direct effect[312], and the formulation of general principles of EU law that may impact the enforcement of EU law by individual private parties in horizontal relations.[313] A telling example of the latter is for instance the *Mangold* decision that involved a claim based on a German law that allowed for lower protection for older employees (as defined in the German statute) compared to other employees.[314] An employee subject to the special regime filed claim against his (private) employer for unequal treatment based on his age and claimed protection under a European directive that established a general framework for equal treatment in employment and occupation matters.[315] The lack of horizontal effect normally would have precluded the claim from being successful, yet the EU court ruled that based on the general principle of equal treatment underlying EU law, discrimination based on age was prohibited.[316] This line of reasoning implies that the directive was not even needed to invoke a private right, the lack of direct effect was bypassed by recourse made on a general principle discerned in various international instruments and in the constitutional traditions common to the Member States, according to the court.[317]

Again, it is demonstrated that the case law of EU courts may have considerable impact on private law enforcement where EU law has not expressly provided for it. While these dynamics and evolutions in the ECJ case law bear relevance for the development of the European enforcement doctrine in general, scholars in the field of financial law have increasingly turned their attention to the potential significance of EU courts' case law on the principle of effectiveness. In the field of competition law, it was indeed the principle of effectiveness that formed the legal basis for the ECJ to introduce a private right of action to enforce EU competition rules directly against other private parties.[318] This principle

[311] See for instance: CRAIG and DE BÚRCA, *EU Law*, ch. 5, 181 ff.; STUYCK, 'The European Court of Justice', 101; S. WEATHERILL and D. LECZYKIEWICZ (eds.), *Involvement of EU law in private law relationships*, Oxford, Portland, Hart Publishing, 2013, 433p.; JOHNSTON and UNBERATH, 'Law at, to or from the Centre?', 149; D. LECZYKIEWICZ, 'Private party liability in EU law: In search of the general regime', C. BARNARD and O. ODUDU, *Cambridge Yearbook of European Legal Studies*, vol. 12, Oxford, Hart Publishing, 2009-2010, 257.

[312] CRAIG and DE BÚRCA, *EU Law*, 196; DOUGAN, 'The Disguised Vertical Direct Effect or Directives', 586-612; CRAIG, 'The legal effect of directives: policy, rules and exceptions', 364-369.

[313] Case C-144/04 *Mangold v Helm* [2005] ECR I-9981. See also: Case C-555/07 *Seda Kücükdeveci* [2010] ECR I-365. See on these decisions and their implications also: WEATHERILL, 'The elusive character', 22; A. ALBORS-LLORENS, 'Keeping up appearances: the Court of Justice and the effects of EU Directives', 63 *Cambridge L.J.*, 2010, iss. 3, 455; M. DOUGAN, 'The impact of the general principles of Union law upon private relationships', S. WEATHERILL and D. LECZYKIEWICZ, *Involvement of EU law in private law relationships*, Oxford, Portland, Hart Publishing, 2013, 71; M. HESSELINK, 'The general principles of civil law', S. WEATHERILL and D. LECZYKIEWICZ, *Involvement of EU law in private law relationships*, Oxford, Portland, Hart Publishing, 2013, 132.

[314] The law particularly made it easier to conclude fixed-term employment contracts with older persons.

[315] Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation, *OJ* L 303/16.

[316] The court particularly stated (para. 74): "Directive 2000/78 does not itself lay down the principle of equal treatment in the field of employment and occupation […]. Indeed, […] the source of the actual principle underlying the prohibition of those forms of discrimination being found, as is clear from the third and fourth recitals in the preamble to the directive, in various international instruments and in the constitutional traditions common to the Member States." Case C-144/04 *Mangold v Helm* [2005] ECR I-9981.

[317] WEATHERILL, 'The elusive character', 22.

[318] ECJ, Case 453/99, *Courage* v *Crehan*, [2001] ECR I-6297; Joined cases C-295/04 and C-298/04 *Manfredi* [2006] ECR I-6619, 25-26. Extensively on this decision: A. ALBORS-LLORENS, 'Courage v. Crehan: Judicial Activism or Consistent ', 61 *Cambridge L.J.*, 2002, 38-41; D. VAN GERVEN 'Private Enforcement of EC Competition Rules in the ECJ: Courage v. Crehan and the Way Ahead', in J. BASEDOW (ed.), *Private Enforcement of EC Competition Law*, Alphen aan den Rijn, Kluwer, 2007, 19-38; MILUTINOVIC, *The 'Right to Damages'*, 69 ff.

and its potential relevance with regard to private enforcement of EU capital market law is explained in more detail below.

ii) Europeanization of remedies and procedures in the light of the principle of adequate judicial protection

88. Adequate judicial protection. – According to longstanding case law passed by ECJ, Member States are required to effectively and adequately protect rights conferred upon individuals by EU law.[319] The principle of adequate judicial protection was initially derived from the principle of sincere cooperation laid down in art. 4 (3) TEU, from the constitutional traditions common to the Member States, and was also considered to be embedded in art. 6 and 13 European Convention for the Protection of Human Rights and Fundamental Freedoms and art. 47 of the Charter of fundamental rights of the EU.[320] Nowadays, the principle of effective judicial protection has been expressly provided for by the enactment of art. 19(1) TEU, which may be understood as a confirmation of the role the ECJ took up in supervising and monitoring the enforcement of EU law by the Treaty of the European Union.[321]

(a) Principles of effectiveness and equivalence

89. According to the ECJ case law, the principle of effective judicial protection requires effective enforcement of EU rights conferred on individuals. However, as there is no European Union law governing the procedures and remedies to enforce these rights, these matters are governed by the national laws of the Member States.[322] National courts are therefore required to ensure the effectiveness of EU law using the national procedural and remedial legal framework of the Member States, provided that the national rules respect the effectiveness of EU law (principle of effectiveness or '*effet utile'*) and the equivalence of EU and national laws. The principles of effectiveness and equivalence are considered parameters according to which the appropriateness of the domestic remedial and procedural framework is assessed by the EU courts.

90. Principle of equivalence. – In its role as supervising authority over the national courts to ensure that EU law is adequately enforced and complied with, the ECJ developed the principle of equivalence that implies that national courts are to apply procedural rules applicable to claims based on EU law in a similar manner, that is, not less favorable than they are applied to claims based on national law.[323] Estimating equivalence, national courts should take into account the role played by the

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[319] ECJ, Case C-432/05 *Unibet Ltd v Justitiekanslern* [2007] ECR I-2271, para. 37. See also: CRAIG and DE BÚRCA, *EU Law*, 218; M. TABOROWSKI, 'Case C-432/05 Unibet - Some practical remarks on effective judicial protection', 14 *Colum. J. Eur. L.*, 2008, iss. 3, 621; DOUGAN, *National remedies*, 54; EDWARD and LANE, *European Union Law*, 312, para. 6.28 ff.

[320] See the references in the previous footnote.

[321] Art. 19 (1) TEU: "The Court of Justice of the European Union shall include the Court of Justice, the General Court and specialized courts. It shall ensure that in the interpretation and application of the Treaties the law is observed." Art. 19 (1) was added by the Lisbon Treaty.

[322] Case 33-76, *Rewe-Zentralfinanz eG et Rewe-Zentral AG v Landwirtschaftskammer für das Saarland*, [1976] ECR 1989: 'Accordingly , in the absence of community rules on this subject , it is for the domestic legal system of each member state to designate the courts having jurisdiction and to determine the procedural conditions governing actions at law intended to ensure the protection of the rights which citizens have from the direct effect of community law, […]".

[323] See for instance: ECJ, 16 December 1976, Case 33-76, *Rewe-Zentralfinanz eG et Rewe-Zentral AG v Landwirtschaftskammer für das Saarland*, [1976] ECR 1989: 'Accordingly , in the absence of community rules on this subject , it is for the domestic legal system of each member state to designate the courts having jurisdiction and to determine the procedural conditions governing actions at law intended to ensure the protection of the rights which citizens have from

national rules in the procedure as a whole, as well as the operation of any special features of that procedure before the different national courts.[324]

91. Principle of effectiveness. – A second principle laid down by the EU courts in scrutinizing the national enforcement of EU law infringements is the principle of effectiveness (‘*effet utile’*) and the principle of equivalence as general legal principles.[325] The principle of effectiveness essentially holds that Member States are required to enable EU law to take full effect within their national legal frameworks, and is handled as an instrument by the ECJ to scrutinize the Member States’ procedural and substantive laws that may have an impact on the effectiveness of EU law.[326] The dividing line between the Member States’ discretion in remedial and procedural rules on the one hand, and the scope of these European principles on the other has proven dynamic and requires that the various interests at stake – being member state autonomy and EU law effectiveness – are unremittingly (re)balanced by both European and national courts.

(b) Tension between the preserved discretion of the Member States and the principle of adequate judicial protection

92. Since EU Treaties nor Community legislation govern these matters, remedial laws along with the procedural rules to obtain redress for breaches of EU law are traditionally considered within the Member States’ discretionary powers.[327] Hence, EU law is to be enforced within the national legal framework with national remedies and national procedural rules, provided that the fundamental principles of equivalence and effectiveness are respected. To the extent national laws preclude the effectiveness of EU law, the ECJ may step in trough preliminary questions considering national procedural laws in the light of the effectiveness requirement. This assessment clearly requires a

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the direct effect of community law, it being understood that such conditions cannot be less favorable than those relating to similar actions of a domestic nature’. See also: Case 45/76 *Comet* v *Produktschap* [1976] ECR 2043, para. 19; Case C-5/94, *Hedley Lomas* [1996] ECR I-2604, para. 31; Case 326/86 *Levez v Thomas Jennings (Harlow Pools) Ltd* [1998] ECR I-7835, para 41; Case C-470/03 *A.G.M.-Cos.MET Srl v Suomen valtio and Tarmo Lehtinen* [2007] *ECR* I-2749, para. 89; Case C-40/08 *Asturcom Telecomunicaciones SL v Rodriguez Nogueira* [2009] ECR I-9579 DOUGAN, *National remedies*, 24-26 ff.; ARNULL, *The European Union and its Court of Justice*, 332-333.

[324] Case 326/86 *Levez v Thomas Jennings (Harlow Pools) Ltd* [1998] ECR I-7835, para. 44. DOUGAN, *National remedies*, 24-26.

[325] For an overview with regard to the principle of effectiveness and equivalence: CRAIG and DE BÚRCA, *EU Law*, 231 ff.; P. ROTT, 'The Court of Justice's principle of effectiveness and its unforeseeable impact on private law relationships', S. WEATHERILL and D. LECZYKIEWICZ, *Involvement of EU law in private law relationships*, Oxford, Portland, Hart Publishing, 2013, 180; DOUGAN, *National remedies*, 26 ff; P. NEBBIA, 'The double life of effectiveness', 10 *The Cambridge Yearbook of European legal studies*, 2007-2008, 287-302; TRIDIMAS, *General Principles*, 418 ff.; F. SMITH and L. WOODS, 'Causation in *Francovich*: the neglected problem' 46 *I.C.L.Q.*, 1997, 926; G. ANAGNOSTARAS, ‘Not as unproblematic as you might think: the establishment of causation in governmental liability actions’, *European Law Review* 2002, 664.

[326] See the references cited in the previous footnotes with regard to the principle of effectiveness. See with regard to ECJ case law on the principle of effectiveness amongst many others: Case 33-76, *Rewe-Zentralfinanz eG et Rewe-Zentral AG v Landwirtschaftskammer für das Saarland*, [1976] ECR 1989; Case 45/76 *Comet* v *Produktschap* [1976] ECR 2043; ECJ, Case 453/99 *Courage* v *Crehan* [2001] ECR I-6297; Joined cases C-295/04 and C-298/04 *Manfredi* [2006] ECR I-6619; Case C-88/99 *Roquette Frères SA v Direction des services fiscaux du Pas-de-Calais* [2000] ECR I-101465; C-526/04, *Laboratoires Boiron SA* v *Union de recouvrement des cotisations de sécurité sociale et d'allocations familiales (Urssaf) de Lyon*, [2006] ECR I-7529; Case C-432/05, *Unibet Ltd v Justitiekanslern*, [2007] ECR I-2271.

[327] As the ECJ generally formulates the principle: “in the absence of Community legislation, it is for the Member States to lay down the procedural rules for legal proceedings intended to protect the rights conferred to individuals by EC law”. See for instance: Case 33/76 *Rewe-Zentralfinanz eG et Rewe-Zentral AG v Landwirtschaftskammer für das Saarland* [1976] ECR 1989, para.5; Joined cases C-6 and C9/90, *Francovich and Others* v *Italy* [1991] ECR I-5357, para 42; ECJ, 25 July 1991, Case C-208/90, *Theresa Emmott v Minister for Social Welfare and Attorney General*, [1991] ECR I-4269, para. 16. See also: H.-W. MICKLITZ, 'The ECJ between the individual citizen and the Member States - A plea for judge-made European law on remedies', H.-W. MICKLITZ and B. DE WITTE, Cambridge, Intersentia, 2012, 366, stating that the ECJ actually fills a gap resulting from the absence of rules on a European procedural law.

balance to be struck between the Member States' autonomy to organize (EU) law enforcement and the need to guarantee the effectiveness of EU law. Over time, however, this balance has proven to be susceptible to evolution and gradual (re)assessment.[328] More particularly, whereas early case law of the ECJ stressed the principle of national autonomy in the field of remedies and procedural rights, later case law increasingly shifted the focus to the obligation imposed on Member States to provide for adequate protection. The obligation to provide for adequate protection obviously causes tension with the Member States' assumed discretionary powers in terms of remedies. This tension for instance clearly surfaces in case law relating to the question whether the creation of new remedies is required in those cases where national law has not provided one. Early case law in this regard stressed that no obligation to design new remedies was included and emphasized the Member States' procedural and remedial autonomy.[329] Later case law however held that specific substantive remedies may be needed to ensure the effectiveness of EU rights, thereby partially eroding its prior position on national remedial discretion.[330]

Illustrative in this regard is the Court's decision in *Courage v Crehan*.[331] The case concerned a plaintiff who was party to a contract with the defendant, claiming for damages as a result of the defendant's breach of EU competition law. It was argued and established that the contract between the parties implied a forbidden restriction of competition, which was considered harmful to the relevant market and had caused the plaintiff to suffer loss. However, as UK law bars claims for damages in cases where the plaintiff is part to a prohibited agreement, the plaintiff was not considered entitled to damages under UK law. Upon request to deliver an opinion on the judgment, the UK appellate court raised the question whether the UK procedural rule was compatible with the protection offered by art. 101 TFEU (former art. 85 (1) EC Treaty or 81 EC Treaty). As the appellate court referred the question to the ECJ for a preliminary ruling, the latter held that in the light of the direct effect of EU Treaty law, the fundamental importance of art. 101 TFEU to the functioning of the EU, and the direct effect of EU Treaty law between individuals, any individual should be able to rely on art. 101 TFEU in the national courts.[332] Additionally, given the obligation to render EU law fully effective in the national legal order, individuals must be able to claim damages for loss caused by the breach of art. 101 TFEU.[333]

[328] For an overview, consult: CRAIG and DE BÚRCA, *EU Law*, 219 ff.; ARNULL, *The European Union and its Court of Justice*, 267 ff. A. ARNULL, 'The Principle of Effective Judicial Protection in EU law: An Unruly Horse? ' 36 *ELR* 2011, iss. 1, 51-70. See also: G. BECK, *The legal reasoning of the Court of Justice of the EU*, Oxford, Portland, Hart Publishing, 2012, 288; A. ADINOLFI, 'The "procedural autonomy" of Member States and the constraints stemming from the ECJ's case law', H.-W. MICKLITZ and B. DE WITTE, *The European Court of Justice and the autonomy of the Member States*, Cambridge, Intersentia, 2012, 281.

[329] Case C-14/83 *von Colson and Kamann* [1984] ECR I-1891, para. 23, stating that "Although, […], full implementation of the directive does not require any specific form of sanction for unlawful discrimination, it does entail that that sanction be such as to guarantee real and effective judicial protection". See also: ECJ, 7 July 1981, Case 158/80, *Rewe-Handelsgesellschaft Nord mbH and Rewe-Markt Steffen v Hauptzollamt Kiel*, [1981] ECR 1805. Comp. however: ECJ, 9 November 1983, case 199/82, *Amministrazione delle Finanze dello Stato v SpA San Giorgio*, [1983] ECR 3595.

[330] Case C-410/98 *Metallgesellschaft & Hoechst v Inland Revenue* [2001] ECR I-4727; ECJ, Case 453/99 *Courage* v *Crehan* [2001] ECR I-6297; Joined cases C-295/04 and C-298/04 *Manfredi* [2006] ECR I-6619; Case C-253/00 *Muñoz y Cia SA and Superior Fruiticola SA v Frumar Ltd and Redbridge Produce Marketing Ltd* [2002] ECR I-7289; Joined cases C-154-149/08 *Club Hotel Loutraki AE* [2010] ECR I-4165 for examples of cases in which the ECJ considered that a specific remedy was required to remedy infringements of EU law effectively. See in this regard also for an overview of the relevant case law: CRAIG and DE BÚRCA, *EU Law*, 229 ff. The *Unibet* case from 2007 though again confirms the former developed principle that courts are principally not required to provide for new remedies in cases where there are none existent. ECJ, Case C-432/05, *Unibet Ltd v Justitiekanslern*, [2007] ECR I-2271.

[331] ECJ, Case 453/99 *Courage* v *Crehan* [2001] ECR I-6297.

[332] Idem, nrs. 19-24.

[333] Idem, nrs. 25-28.

Otherwise, the effect of the prohibition laid down in art. 101 TFEU would be put at risk.[334] The holding in *Courage* was unequivocally confirmed in the subsequent *Manfredi* judgment of the ECJ.[335]

The landmark decisions *Courage* and *Manfredi* marked a watershed regarding private enforcement of EU competition law and the interaction between the national and the EU level in this field of law.[336] Not only did these decisions grant a private right for individuals to seek compensation for breaches of EU competition law, they also set the stage for the Commission's green and white paper setting out the intention of the Commission to pursue more involvement in private enforcement of antitrust law[337], which has recently resulted in a proposal for a directive to facilitate damage claims by victims of antitrust violations.[338] The draft directive once more highlights the increasing interest at the EU level – and the EU Commission in particular – for private enforcement of EU (competition) law. Moreover, in other EU court decisions and other fields of law an increasing impact of the EU courts has been felt too, for instance with regard to the right of standing[339], time limits imposed to file claims[340], causation[341], remoteness, the measurement of damages[342] and so on. Although these assessments take place on a case by case basis and in a wide range of areas, some general principles can be distilled, clarifying how the EU courts interpret and apply these concepts. With regard to evidentiary rules for instance, a case on state aid, *Boiron*, holds that in case national courts find that evidentiary requirements render it excessively difficult to establish a claim, the courts are required 'to use all procedures available to it under national law' to allow the claimant to enforce the rights he has been attributed.[343] In a similar manner, the EU courts have recurrently held that the conditions to impose liability pursuant to a breach of European Union law are within the Member States' national courts' discretion, yet various decisions show that the ECJ and the ECFI have nevertheless gradually adopted rules on certain aspects related to the matter.[344]A notable example is the *Manfredi* judgment, in which

[334] Idem, nr. 26.

[335] Joined cases C-295/04 and C-298/04 *Manfredi* [2006] ECR I-6619.

[336] Similar: MILUTINOVIC, *The 'Right to Damages'*, 349, observing that "at no point in the past did the Commission seek such profound inroads into national rules of civil liability, procedure and remedies". The author also notes that competition rules in the inter-state context are an area of exclusive Union competence, which facilitates European interference in this area of law.

[337] Green Paper Damages Actions for Breach of the EC Antitrust Rules, Commission of the European Communities, COM (2005) 672 final. Commission Staff Working Paper, Annex to the Green Paper Damages actions for breach of the EC antitrust rules, Brussels, 19 December 2005, SEC(2005) 1732, available at http://ec.europa.eu. The Green paper was followed by the White Paper: White paper on damages actions for breach of the EC antitrust rules, Brussels, 2 April 2008, COM (2005) 672 final, available at http://ec.europa.eu. The Commission also announced a legislative initiative to ensure effective damages actions before national courts for breaches of EU antitrust rules; consult in this regard: Annex to the communication from the commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Brussels, 15 November 2011, COM(2011) 777 final, http://ec.europa.eu.

[338] Proposal for a Directive of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union, COM(2013) 404 final, Strasbourg, http://eur-lex.europa.eu. See on the proposal more extensively: DRIJBER, 'Het Richtlijnvoorstel over schadevorderingen wegens mededingingsinbreuken', 489.

[339] Case C-432/05, *Unibet Ltd v Justitiekanslern*, [2007] ECR I-2271.

[340] Case C-246/96, *Magorrian and Cunningham v EHSSB and DHSS* [1997] ECR I-7186; Case C-78/98, *Preston and Others v Wolverhampton Healthcare NHS Trust and Others* [2000] ECR I-3201; Case C-542/08, *Friedrich G Barth v Bundesministerium für Wissenschaft und Forschung* [2010] ECR I-3189.

[341] The court assessed the causal relation for the first time in Case 316/96 *Brinkmann Tabakfabriken/Skatteministeriet* [1998] ECR I-5255; This was repeated in following cases, such as (amongst others): Case C-140/97, *Rechberger and Others v Republic of Austria* [1999] ECR I-3499.

[342] Joined cases C-295/04 and C-298/04 *Manfredi* [2006] ECR I-6619; Case C-215/08 *Friz GmbH* [2010] ECR I- 2947.

[343] ECJ, 7 September 2006, C-526/04, *Laboratoires Boiron SA* v *Union de recouvrement des cotisations de sécurité sociale et d'allocations familiales (Urssaf) de Lyon* [2006] ECR I-7529, para. 55.

[344] On the role of the ECJ in private law matters, see also: STUYCK, 'The European Court of Justice', 101-115; C.U. SCHMID, 'The Three Lives of European Private Law', L. ANTONIOLLI and F. FIORENTINI, *A Factual Assessment of the Draft Common Frame of Reference*, Munich, Sellier, 2011, 307 ff.; BASEDOW, 'The Gradual Emergence of European Private Law', 1-18.

the court ruled on the interpretation of recoverable loss for infringements of EU competition law (art. 101 TFEU).[345] Setting out with the acknowledgment that the application of the concepts 'causation', 'damage' and the quantification of the damages falls within the Member States' responsibility and competences, the court nonetheless concludes that in order to be effective, compensation should remedy both the actual loss (*damnum emergens*) and loss of profit (*lucrum cessans*) plus interest.[346]

In other areas as well, the EU courts have ruled on remedial and procedural matters that were traditionally considered within the Member States' province, notably in areas involving consumer law, the fundamental freedoms of the EU and matters of equal treatment in the context of employment and occupation law.[347] With regard to financial consumers for instance, the court considered the scope of a contract cancellation right that aimed to remedy irregularities that had occurred in a doorstep transaction governed by Council Directive 85/577/EEC.[348] The case particularly concerned a consumer who had agreed to enter into a closed-end real property fund, established in the form of a partnership, following an unsolicited doorstep transaction. In accordance with art. 5(2) of the relevant directive[349], the consumer made use of his cancellation right and ended his membership in the partnership of the closed-end real property fund. However, the German transposition of the European cancellation right does not allow for the cancellation to have retroactive effect but instead holds that in case of loss or damage to the object to be returned following the cancellation, the consumer is obliged to sustain the difference in value of the object to the contract party and might even have to participate in the losses of the fund as it stands at the date of cancellation.[350] Since the fund had lost money and struggled with a negative balance, the consumer was not only unable to recover the investment made at the start of the membership, but also had to cover up for the negative severance balance at the moment of cancellation. Following the consumer's refusal to comply with these obligations, suits were filed and made their way to the German *Bundesgerichtshof* (German Supreme Court) that asked for a preliminary ruling on the question whether and to what extent national law may restrict the legal effects of the European cancellation right.[351] Upon confirming its competence to rule on the issue and the obligation of the Member State to ensure that the directive is fully effective, the ECJ held that effective consumer protection does not amount to absolute protection, indicating that the protection offered by the directive may have limits.[352] Considering that the German rule aims to ensure a fair division of risks between the parties and that investments inherently bear risks that should be borne by the investor rather than other parties, the ECJ considers the German law in line with the demands of

[345] Joined cases C-295/04 and C-298/04 *Manfredi* [2006] ECR I-6619.

[346] Joined cases C-295/04 and C-298/04 *Manfredi* [2006] ECR I-6619, paras. 88 and 92, and para. 95: "[…] it follows from the principle of effectiveness and the right of any individual to seek compensation for loss caused by a contract or by conduct liable to restrict or distort competition that aggrieved persons must be able to seek compensation not only for actual loss (damnum emergens) but also for loss of profit (lucrum cessans) plus interest."

[347] For more extensive overviews, see: WEATHERILL, 'The elusive character', 9; STUYCK, 'The European Court of Justice', 101; JOHNSTON and UNBERATH, 'Law at, to or from the Centre?', 149.

[348] Case C-215/08 *Friz GmbH* [2010] ECR I- 2947. For a discussion of this decision, see also: HESSELINK, 'General principles', 137.

[349] Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises, *OJ* L 372, p. 31-33. Art. 5(2) of Directive 85/577/EEC was transposed into §3 Haustürwiderrufsgesetz ('HWiG', or Gesetz vom 16 Januar über den Widerruf von Haustürgeschäften und ähnlichen Geschäften BGBl. I S. 122 aufgehoben durch Gesetz vom 26.11.2001 (BGBl. I S. 3138) m.W.v 01.01.2002 in German law).

[350] § 3(1) HWiG.

[351] Again, this preliminary question essentially refers to the effectiveness principle (effet utile), as the court inquires whether the German regulation renders the European consumer right to cancel a transaction ineffective by holding the latter liable for the decline in the value of the object in question.

[352] Case C-215/08 *Friz GmbH* [2010] ECR I- 2947, para. 44.

the directive.[353] This decision is not only in its kind, however. Other decisions ruling on appropriate remedies in the context of EU consumer law preceded this decision.[354] Compared to the EU legislator, the EU courts seem to harmonize private liability issues at a faster pace, albeit on a fragmented and piecemeal basis.[355]

c. Assessment and outlook

93. The analysis of the EU courts' case law clearly shows an increasing impact of EU law on private law relationships, covering areas that were traditionally considered within the national legal sphere. As noted in the scholarly literature however, the 'Europeanization' of national remedies and procedures is fragmented and depends on the area of law at matter.[356] For example, the developments in the field of competition law seem to have been confined to the reach of EU competition law and do not seem to allow for generalization.[357] Assessments of whether rights have been conferred to individuals, the scope thereof and the means to enforce them are to be made based on a case by case-analysis of the relevant legislative provisions and cannot be derived from other decisions that have been limited in scope. Overall, it is clear however that the ECJ succeeds in establishing liability rights

[353] Case C-215/08 *Friz GmbH* [2010] ECR I- 2947, para. 48-49: "As the *Bundesgerichtshof* observed in its decision for reference, that rule is intended to ensure, in accordance with the general principles of civil law, a satisfactory balance and a fair division of the risks among the various interested parties." and: "Specifically, first, such a rule offers the consumer cancelling his membership of a closed-end real property fund established in the form of a partnership the opportunity to recover his holding, while taking on a proportion of the risks inherent to any capital investment of the type at issue in the main proceedings. Secondly, it also enables the other partners or third party creditors, in circumstances such as those of the main proceedings, not to have to bear the financial consequences of the cancellation of that membership, which moreover occurred following the signature of a contract to which they were not party."

[354] See in this regard for instance Case C-489-07 *Pia Messner v Firma Stefan Krüger* [2009] ECR I-731, or the ECJ decision in *Leitner*, concerning a consumer law dispute, in which the concept of 'damages' was discussed in the context of the Package Travel Directive (Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours, *OJ* L 158/59). The disputed matter particularly concerned the scope of recoverable loss under the Package Travel Directive, which provides a right to compensation for improper performance of the obligations arising from the consumer contract regulated by the directive. The ECJ was specifically asked whether non-material damage was recoverable according to the directive. Even thought the heads of damages is traditionally considered a matter of national law, the ECJ held in this case that 'damages' in the context of the Package Travel Directive indeed included non-material damage suffered by the claimant. Case C-168/00, Simone Leitner v TUI Deutschland GmbH & Co. KG, [2002] ECR I-2631. See on this decision also: JOHNSTON and UNBERATH, 'Law at, to or from the Centre?', 149. The authors note that this interpretation of damages is likely to reach well beyond the mere rules harmonized by the directive and affect the notion of damages in other regulatory settings as well, creating a 'spillover' in other words (p.91-92). See on this topic also: LECZYKIEWICZ, 'Private party liability', 257.

[355] WEATHERILL, 'The elusive character', 9. The author notes that EU law has spread in the private legal sphere just as it spread in other areas too, be it that a consistent pattern is lacking, causing EU law to have an impact on private law relationships in various fields of law with different implications and to various degrees. Along the same lines, ADINOLFI asserts that the Court's approach is shaped by the degree of substantive harmonization that is attained in the particular areas of law. ADINOLFI, 'Procedural autonomy', 299; See in this regard also: STUYCK, 'The European Court of Justice', 101. Examining European law that has been enacted on remedial matters, ARNULL notes that " [t]he political institutions were slow to respond to the Court's early pleas for comprehensive legislative action on remedies and even now Union legislation in that field remains piecemeal in nature." ARNULL, 'The Principle of Effective Judicial Protection in EU law: An Unruly Horse?', 63.

[356] See the references cited in the previous ftn.

[357] In *Courage* for instance, the ECJ stressed the fact that art. 101 TFEU art. 101 TFEU is Treaty law, fundamental to carry out the EU project and produces direct effect in the national legal orders between individuals (horizontal direct effect). Without the right to claim damages for loss caused by breach, art. 101 TFEU would be deprived from its full effectiveness, especially since the practical effect of the prohibition laid down in the provision would be put at risk. ECJ, Case 453/99 *Courage* v *Crehan* [2001] ECR I-6297, para.26. See for an analysis: LECZYKIEWICZ, 'Private party liability', 261 ff.; WEATHERILL, 'The elusive character', 26. See however also: MILUTINOVIC, *The 'Right to Damages'*, 353-354. The author notes that in addition to the area of competition law, other areas of EU law may become 'affected', including areas regulated by directives via the indirect effect-doctrine that obliges national courts to interpret national law in line with directives. See also on European private legal remedies based on the principle of adequate judicial protection: MAK, 'Rights and Remedies', 20 p.

where EU legislation on its face has not explicitly provided for it, therefore expanding the influence of EU law in private law relationships.

94. These evolutions have been looked on with mixed feelings in the scholarly literature. Some have applauded the increasing interest and influence of the EU level in enforcement and private law matters arguing that EU law would remain dead letter otherwise.[358] To these commentators, the lack of private rights of action to enforce the rules against those who are supposed to be bound by it renders EU law incomplete.[359] Others however consider the extending impact of the effectiveness principle a (potential) Trojan horse, used by the European level to (gradually) impinge upon matters that were traditionally considered within the discretionary powers of the Member States under the legitimizing pretext of enhancing the general effectiveness and harmonizing effect of Community law.[360] According to these authors, the ECJ seeks to exert influence in remedial matters, an area in which the EU legislator is still struggling to gain authority and elbow room, thereby neglecting and even undermining the role of the EU legislator.[361]

95. Regardless of how one feels towards this evolution though, the course of events appears irreversible and should raise caution and awareness of the ECJ's monitoring function in assessing the national legal frameworks implementing EU law. In those cases where civil liability has been explicitly mentioned as a means to enforce the rules, Member States should be aware that this obliges them to provide for an effective liability system in order to comply. National procedural and remedial rules withholding allegedly aggrieved claimants from invoking liability are likely to be at odds with obligations as interpreted by the EU courts. The argument purporting to the remedial and procedural discretion is no safeguard from Member State liability, even if this implies that Member States are to review and even reshape their remedial apparatus in the light of EU law to comply.[362] The reach and potential impact of the principle of effectiveness on EU capital market law in particular is considered in detail in the next section.

2. Private enforcement of EU capital market law in the light of the EU courts' case law

96. The analysis of the EU capital market legislation demonstrated that whereas UCITS, the Prospectus and the Transparency Directive require the Member States to apply their national civil liability laws to the provisions contained in these directives, MiFID and Market Abuse Directive and (future) Market Abuse Regulation do not contain such obligations. Overall, the requirements imposed on the Member States with regard to private enforcement of the rules are general in scope and limited

[358] REICH, 'Interrelation between rights and duties in EU law', 118-120.

[359] *Ibid.* 120. The mere use of the vertical 'state track' to enforce EU rights turns the state into a sort of 'godfather guarantor' of EU subjective rights, as REICH formulates the current state of play (p. 121).

[360] WEATHERILL, 'The elusive character', 23; D. LECZYKIEWICZ, 'The constitutional dimension of private law liability rules in the EU', S. WEATHERILL and D. LECZYKIEWICZ, *Involvement of EU law in private law relationships*, Oxford, Portland, Hart Publishing, 2013, 214. On the topic of the ECJ's installment of private party liability, see also: LECZYKIEWICZ, 'Private party liability', 257-282.

[361] WEATHERILL, 'The elusive character', 23; LECZYKIEWICZ, 'The constitutional dimension', 214; M. ROSS, 'Effectiveness in the European legal order(s): beyond supremacy to constitutional proportionality?', 31 *ELJ*, 2006, iss. 4, 476: "[…] in the context of the European Union, a key question is whether law and politics are moving in the same direction when it comes to line drawing. The Constitutional Treaty 2004 […] demonstrated the political desire to seek clearer boundaries between Union and national competences. […] Yet, at the same time and in contrast, the European Courts continue to (re) map the European legal landscape on foundations of ever more porous and flexible arrangements drawn from a variety of sources and influences." (p.476-477).

[362] REICH, 'Interrelation between rights and duties in EU law', 124.

in effect. In the light of the aforementioned evolutions taking place in the EU courts, it is analyzed whether and to what extent the case law of the EU courts and the doctrine of effectiveness in particular may impose additional or more specific requirements on the Member States to remedy breaches of EU capital market law.

a. The clear cut case of explicit provisions on civil liability law in EU capital market legislation

97. UCITS, the CRA Regulation, the AIFMD, the Prospectus and the Transparency Directive impose an obligation to apply national civil liability rules in case of violation of the legislation introduced pursuant to those directives.[363] Based on these provisions, individual investors are granted the right to privately enforce (some of) the rules contained in these directives. UCITS and the AIFMD focus on liability of depositaries, the CRA Regulation provides for a list that enumerates violations that are privately enforceable in the national courts, while the Prospectus and the Transparency Directive require that the national liability rules are applied in case of violations. On its face, EU capital market law generally seems to redirect investors to the national liability laws.[364] In the light of the effectiveness doctrine, however, Member States may be required to do more than simply declare their national liability laws applicable to breaches of the implemented rules. More particularly, to the extent general liability rules, evidentiary rules and/or other procedural rules pose serious hurdles to investors to enforce their rights, adjusted or specific rules deviating from the general liability system may be required to comply with EU law.[365] As traditional liability law was indeed considered to raise such barriers in some of the Member States, legal reforms were carried out in order to comply with the obligations under EU capital market law. The enactment of s.90A FSMA on secondary market information liability (including both periodic and ad hoc disclosure obligations) in the UK and the introduction of the Spanish prospectus liability regime following the Prospectus Directive are illustrative examples in this regard.[366] In the UK for instance, the legislative reform was the direct result of doubts whether the common law tort rules would suffice the requirements laid down in the Transparency Directive.[367] Even though the directive did not explicitly require that the Member States to adopt specific liability rules, concerns were raised that the UK courts, potentially influenced by the '*effet utile'* case law of the ECJ, may not consider the current state of law compliant. It was particularly feared that leaning on the rationale of investor protection, which was explicitly mentioned in the directive, courts may go further in an investor protection interpretation of the law and overrule

[363] The references in the Prospectus and Transparency Directive regarding civil liability were discussed earlier (see *supra*).

[364] For instance, Germany, France and for instance do not have specific liability rules that apply in case of violation of the periodic reporting obligations as laid down in the Transparency Directive, but instead apply their general civil liability laws in these cases. See with regard to Germany also: VEIL (ed.), *European capital markets law*, 265; HELLGARDT, 'Europarechtliche Vorgaben', 154.

[365] For a similar point of view, see DAVIES: "Although Article 7 merely requires Member States to extend their civil liability regimes to the disclosures required by the Directive, it is strongly arguable that this does require the Member State to have some liability regime to be extended. On this basis, it would not constitute compliance with Community law for a Member State to say that it had no liability regime or a liability regime which in practice was wholly ineffective"; DAVIES, 'Davies review. Discussion paper', 26, para. 54. See on this topic also: TISON, 'Civil law effects',; REICH, 'Interrelation between rights and duties in EU law', 149-152; T.M.C. ARONS and A.C.W. PIJLS, 'Prospectus liability in the Netherlands, Consequences of the Unfair Commercial Practices Act (Wet Oneerlijke Handelspraktijken, Wet OHP)', M.C.A. VAN DEN NIEUWENHUIJZEN, *Financial Law in the Netherlands*, Alphen aan den Rijn, Kluwer Law International, 2010, 480-481.

[366] (UK) DAVIES, 'Davies review. Discussion paper', para. 40 ff.; (Spain) SEBASTIÁN and TORTUERO, 'Prospectus liability under the Spanish Securities Market Act: a comparison between the New Spanish Regime and the US regime', 331; VEIL (ed.), *European capital markets law*, 264-265.

[367] DAVIES, 'Davies review. Discussion paper', para. 40 ff.

precedents, such as the *Caparo* decision which denied issuer liability for misleading statements to non-shareholding litigants.[368] Anticipating potential court involvement in reshaping or amending the rules then governing secondary market information liability, the government enacted a statutory tort laid down in s.90A FSMA.[369]

98. Not only legislators understood the implications of the effectiveness doctrine combined with the explicit requirement to have liability rules in place in the Prospectus and Transparency Directive. Confronted with investor claims for compensation for violations of the prospectus rules that threatened to be barred by the evidentiary rules relating to causation, the Dutch Supreme Court adopted a presumption of causation in its landmark decision in *World Online*. In its judgment, the court held that since the Prospectus Directive aims to provide for an effective investor protection against misleading prospectus information, and since the evidentiary rules were a threshold generally too high to meet for investors, it was the court's duty to install a presumption of causation.[370] The implications and effect of this line of case law is discussed in more detail in the third part of this thesis.[371]

b. The less clear cut case of MiFID and the Market Abuse Directive

99. Whereas UCITS, the AIFMD, the CRA Regulation, the Prospectus and the Transparency Directive expressly require the Member States to apply its national private law in case of (certain) breaches, MiFID and the Market Abuse Directive (or future Market Abuse Regulation for that matter) lack such express provisions. Some commentators have nonetheless argued that even though these directives do not contain express provisions on their civil law effect in the Member States' legal order, an intention to provide individual investors with enforceable rights has been implied in these directives and can be derived from the investor protection purpose underlying the directives at matter. As the Member States are required to adequately and effectively protect the rights conferred by EU law on individuals, it has also been asserted that these directives oblige the Member States to allow investors to privately enforce the rules of conduct.[372] Prior to considering the arguments as to whether or not the directives require Member States to provide investors with actionable private rights, we first consider the relevance of the question given the fact that most Member States already provide for national private rights of action in the area of financial services and financial reporting obligations, regardless of the scope of the obligations imposed by MiFID and the Market Abuse Directive.

i) Indirect effect of investor protection measures

100. Because most Member States provide for liability rules applicable to violations of the MiFID rules of conduct, and the disclosure obligations (and to a lesser extent, the rules on market

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[368] Idem.

[369] Idem.

[370] R.o. 4.11.1-2, HR 27 November 2009, *JOR*, 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht*, 2010, 21, with ann. by H.M. VLETTER-VAN DORT.

[371] Part III, Chapter I, para. 329.

[372] With regard to MiFID, reference can be made to TISON, 'Civil law effects', 2621-2639; REICH, 'Interrelation between rights and duties in EU law', 150 ff.; BUSCH, 'Why MiFID matters to private law', 408; for a similar reasoning with regard to the prohibitions on market manipulation and the obligation to disclose inside information promptly, accurately and timely under the Market Abuse Directive, and presumably in a similar sense under the (future) Market Abuse Regulation: HELLGARDT, 'Europarechtliche Vorgaben', 154-168; with regard to the Takeover Bid Directive: RINGE and HELLGARDT, 'International dimension', 29; and: A. HELLGARDT and W.-G. RINGE, 'Internationale Kapitalmarkthaftung als Corporate Haftung', 173 *ZHR*, 2009, 808.

manipulation) under the Market Abuse Directive in their national private laws, the discussion on the private law effect of these directives appears somewhat theoretical.[373] With regard to MiFID for instance, information duties, duties of loyalty, obligations regarding conflicts of interest and the like have been privately enforced in courts by investors long before MiFID came along via general liability law via general concepts such as the duty of care, the duty of good faith and the like.[374] For example, a Belgian court decision dating from the pre-MiFID period held that the duty to inform investors on possible investments imposed on financial service providers is a corollary of the general good faith obligation.[375] The court also clarified that the scope of the information to be provided to the client depends on the needs of the client himself, which is the underlying rationale for the current MiFID client classification system. In Italy, Germany, France and the Netherlands as well, courts have awarded damages for breaches of information duties and other obligations imposed by MiFID long before MiFID came along.[376] The same goes for obligations imposed by the Market Abuse Directive

[373] With regard to Germany for instance, it is noted that §20a WpHG contains a prohibition to carry out market abusive practices. This prohibition aims to protect market integrity and the price formation process on financial markets, but does not aim to protect each individual investor from being the victim of market manipulation, and therefore does not provide individual investors with a cause of action to claim damages for losses suffered as a result of market manipulation. Similarly, in the UK, ss.118, 123 and 383 FSMA that contain rules and a general prohibition to carry out market abuse do not give rise to an actionable civil liability claim in court. Consult in this regard: *Hall v. Cable and Wireless Plc*, (2009) EWHC 1973 (Comm.), at para. 23 where it is stated by Justice TEARE that the Parliament did not intend to attach civil liability to violations of ss.118, 123 and 383 FSMA. Instead it is left to the market supervisor, the Financial Conduct Authority (FCA) to impose fines or issue restitution orders. Restitution orders oblige the person responsible for the breach to pay a sum of money to the FSA which then uses the proceeds to compensate the victims who suffered the losses as a result of the violation. S. 383-184 FSMA. Hence, investors suffering losses due to market abuse may receive compensation, yet they are not entitled to initiate civil proceedings and thus remain dependent on the action undertaken by the FSA (if any). See in this regard also: VEIL (ed.), *European capital markets law*, 199 and 299 ff.

[374] See also: CHEREDNYCHENKO, 'Regulation of Retail Investment Services', 410; CHEREDNYCHENKO, 'European securities regulation', 925-926. See for instance with respect to the Netherlands: Hof 's-Hertogenbosch, 22 June 2010, LJN BM9516, (*X./ABN Amro Bank NV*), available at: www.rechtspraak.nl, r.o. 4. See also: A.G. CASTERMANS and P.W. DEN HOLLANDER, 'Dwaling tussen privaat- en publiekrecht', *WPNR* 2012, 563-574; A.C.W. PIJLS, 'De bijzondere zorgplicht van de financiële dienstverlener', F.G.M. SMEELE and M.A. VERBRUGH, *Opgelegde bescherming' in het bedrijfsrecht. Ratio, methodiek en dynamiek van dwingendrechtelijke bescherming van kwetsbare belangen in het bedrijfsrecht*, Den Haag, Boom Juridische uitgevers, 2010167-193. Belgium: J.-P. BUYLE, 'Les obligations d'information, de renseignement, de mise en garde et de conseil des professionnels de la finance', F. GLANSDORFF, *Les obligations d'information, de renseignement, de mise en garde et de conseil*, Bruxelles, Larcier, 2006, 185; KRUITHOF, 'A different approach', 159-160; X. DIEUX and J.Q. DE CUYPER, 'Questions de responsabilité civile en matière de bancassurfinance', in J.-L. FAGNART (ed.), *Bancassurfinance*, Brussel, Bruylant, 2005, 186. See with respect to Luxembourg: P.-H. CONAC, 'L'obligation de connaître le client (Know Your Customer) en droit bancaire et financier luxembourgeois', *RD banc. fin.*, 2008, n° 2, 56. Germany: BGH, 6 July 1993, XI ZR 12/93, *WM* 1993 1455, holding that the banks offering investment products to client-investors are required to take into account the client's readiness to take risks, his objectives and interest, and recommend suitable products in the light of the client profile. This reasoning is clearly reminiscent of a Know Your Customer-obligation *avant la lettre*.

[375] "Le devoir d'information de l'intermédiaire financier est le corollaire de son devoir général de se comporter de bonne foi. L'intensité de ce devoir varie en fonction des circonstances et notamment des qualifications du client." Brussel, 23 January 2004, *TBH* 2006, 112-116, with ann. 116-118. Similar: Brussel, 17 September 2009, *TBH* 2011, 331-335. See also Brussel, 27 April 2012, *J.L.M.B.*, 2012/25, 1203, holding that the obligations imposed by the rules implementing the then applicable ISD-rules regarding the duty to act loyal and in the interest of the client does not differ from the general duty of care imposed on intermediaries. *Comp*. (France) Cass., comm., 26 February 2008, *Bull. civ* 2008, IVN° 42, jurisdata 2008-042935, (Chaib/soc. Cortal Consors); Cass., comm., 4 November 2008, *Bull. civ* 2008, IVN° 185, jurisdata 2008-045691, (Skorbacki/caisse régionale de Crédit agricole de Champagne Bourgogne). See also: A. COURET, PH. GOUTAY and B. ZABALA, 'France', D. BUSCH and D.A. DE MOTT, *Liability of asset managers*, Oxford, OUP, 2012, 69, para. 3.46.

[376] See amongst many other examples for instance: (The Netherlands) Rb s'-Hertogenbosch 7 July 2010, LJN BN1410 (*X./ NBG Finance B.*V), available at www.rechstpraak.nl. Reference is particularly made to the principles of fairness and reasonableness following from the duty of care imposed on the services provider (r.o. 4.4). See for an extensive discussion on this topic also: VAN BAALEN, *Zorgplichten*, 137 ff. GIUDICI points out that in Italy, hundreds of court decisions have been issued in the last two decades concerning breaches of information obligations, know your customer-rules and best execution duties imposed on financial intermediaries vis-à-vis their client-investors. These decisions are available at: www.ilcaso.it; see also: GIUDICI, 'Private law enforcement', 4.

as most – though not all – Member States Member States provide for private causes of action for breaches of ad hoc disclosure obligations and market manipulation prohibitions.[377]

Moreover, in those Member States where open liability systems apply, such as Belgium and France, private enforcement of legislative provisions is uncontested regardless of their public or private law nature since no limitations in terms of relativity requirements apply in these systems.[378] According to the traditional and open liability rules of these jurisdictions, violations of statutory provisions are breaches of the general duty of care laid down in French and Belgian liability law.[379] This is however different in Member States where relativity (the Netherlands) or so-called '*Schutznorm'* rules (Germany) apply, which generally hold that private parties can only rely on legal provisions to file claims to the extent the legal provisions contain individual rights to those private parties.[380] In Germany for instance it was discussed whether the transposition of the rules of conduct enacted by the ISD was privately actionable as it was doubted that these rules, which were supervisory in nature, were actually aimed at individual investor protection.[381] With regard to MiFID, a minority in the scholarly literature still holds that since the rules of conduct in MiFID too are supervisory in nature, their effect is limited to the relation between supervisor and financial service providers. Yet, even though these authors assert that the MiFID rules of conduct as such do not directly interfere with the private law relation between financial service providers and their clients, they accept that the MiFID rules reflect on the private law relationship ('*Ausstrahlungswirkung'*), with is similar in result.[382] The Dutch legislator by contrast anticipated the question in the drafting documents preparing the transposition of MiFID by unambiguously stating that violations of the supervisory rules enacted to transpose MiFID satisfy the relativity requirement laid down in the art. 6:163 DCC.[383] Notwithstanding the potential restriction of the relativity requirement however, it should be noted that in these countries as well financial intermediaries have been held liable based on court-developed duties of care imposing similar obligations.

101. In the light of the availability of private causes of action, the question whether MiFID and the Market Abuse Directive grant individuals the right to privately enforce the rules these directives contain, seems of limited importance because most of the rules these directives contain are generally

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[377] See *supra*, para. 373.

[378] (Belgium) see for instance: Brussel, 27 April 2012, *JLMB* 2012, no. 25, 1203; Kh. Brussel, 3 February 2011, *DAOR* 2012, nr. 102, 222. See also: TISON, 'Civil law effects', 2631; see particularly with regard to France: COURET, GOUTAY and ZABALA, 'France', 69, para. 3.46. with regard to Belgium in particular: M. KRUITHOF, 'Privaatrechtelijke remedies tegen inbreuken op reglementaire gedragsregels inzake beleggingsdiensten: zorgplicht, know your customer en best execution', X., *La protection du consommateur de produits et services financiers - Bescherming van de consument in het financieel recht*, Cahiers AEDBF/EVBFR - Belgium, vol. 25, Antwerpen, Intersentia, Anthemis, 2012, 158.

[379] Art. 1382 FCC and art. 1382 BCC. TISON, 'Civil law effects', 2631

[380] CHEREDNYCHENKO, 'Regulation of Retail Investment Services', 410; TISON, 'Civil law effects', 2631; D. BUSCH, 'Het 'civiel effect' van MiFID: Europese invloed op aansprakelijkheid van vermogensbeheerders', *Ondernemingsrecht*, 2012, nr. 12, 73, paras. 26 ff.; KRUITHOF, 'Privaatrechtelijke remedies', 158.

[381] F.A. SCHÄFER, R. SETHE and V. LANG (eds.), *Handbuch der Vermögensverwaltung*, München, C.H. Beck, 2012, para. 2; H.D. ASSMANN and R.A. SCHÜTZE, *Handbuch des Kapitalanlagerechts*, München, Beck, 2007 138, para. 105. Extensively: F.C. LEISCH, *'Informationspflichten nach § 31 WpHG'*, München, Beck, 2004, 68 ff., and in particular with regard to §823 BGB: p.86. See also: REICH, 'Interrelation between rights and duties in EU law', 156.

[382] A. FUCHS and M. BOUCHON (eds.), *Wertpapierhandelsgesetz (WpHG): Kommentar*, München, Beck, 2009, 1993; also discussed in: REICH, 'Interrelation between rights and duties in EU law', 156. Extensively from a comparative point of view: TISON, 'Civil law effects', 2631; CHEREDNYCHENKO, 'Regulation of Retail Investment Services', 410.

[383] The legislative history clearly states that *consumers* suffering losses as a result of the breach of MiFID obligations, the relativity requirement is met and will not preclude them from claiming damages. Kamerstukken II , 2005/06, 29 708, no. 19, 393. See also: BUSCH, 'Why MiFID matters to private law', 19.

enforceable under the Member States' private law in any case.[384] The question is nonetheless relevant with regard to the conditions and procedural aspects of private party liability. More particularly, if the European laws grant a right to investors to seek private remedies for breaches of EU law, investors are enabled to demand *effective* liability rules in the light of the ECJ case law and as such, involve the EU courts and their case law in the assessment of whether the national liability rules are sufficiently effective. For example, to the extent particular substantive or procedural rules would be considered to stand in the way of achieving the required degree of effective investor protection, modifications and adjustments to the specific needs of investors in the context of civil liability law may be forced on the Member States by the EU courts. Along similar lines, some commentators contend that in the light of the right to *effective* remedial rights and the fact that investors encounter considerable difficulty in bringing claims for damages following breaches of the MiFID rules of conduct, an alleviation of the evidential rules– particularly with regard to causation – is required to allow investors to effectively enforce the protective rights granted by MiFID in national courts.[385]

These examples illustrate the potential implications of concluding that European capital market law directives have private law effects. More particularly, to the extent European financial law directives would require the Member States to provide in private causes of action, it follows from the principle of effectiveness that these private rights should be rendered effective and may require Member States to adjust or reshape some of their liability rules, to ensure that investors are granted *effective* remedial rights. To the extent the aforementioned directives do not grant individual rights, however, the question whether the violation of the rules contained in these directives should be remedied via civil liability, and by extension whether it is done in an effective manner, remains exclusively national in nature and thus well out of the EU's (and EU courts') reach. This allows for the conclusion that despite the fact that most Member States provide for civil liability rules applicable to breaches of the rules contained in MiFID and the reporting obligations in the Market Abuse Directive, the question still bears considerable relevance.

ii) Direct effect of investor protection measures

102. MiFID and the Market Abuse Directive expressly require that the Member States enforce the rules contained in the directives in a proportionate, effective and dissuasive manner through public authorities empowered to do so.[386] Second, MiFID also obliges the Member States to encourage out of court-redress mechanisms[387] and demands that application of the national rules that implement the directive is ensured through public bodies, consumer organization or professional organizations that take action before the courts or competent administrative bodies in the interest of consumers.[388] The

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[384] This does not apply with regard to market manipulation, however, as breaches of the prohibition on market manipulation are generally not privately actionable under UK and German law (see ftn. 373).

[385] REICH for instance contends that a reversal of the burden of proof (after the example of the German case law regarding (pre)contractual information obligations. See *infra* Part. II, Chapter I, para. 200 in this regard) should be introduced in case of 'sufficiently serious' breaches of the MiFID rules of conduct. REICH, 'Interrelation between rights and duties in EU law', 158-159. Similarly arguing in favor of a reversal of the burden of proof with regard to causation in the context of MiFID: BUSCH, 'Why MiFID matters to private law', 408. In line with the Dutch Supreme Court decision in *World Online,* BUSCH asserts that "in order to provide clients with effective protection, it seem arguable that the presence of the causal connection between the violation of MiFID duties of information or to warn, and the loss suffered by the client, should be the point of departure, because otherwise MiFID's goal of investor protection may become illusionary."

[386] Art. 4(1) (22) in conjunction with art. 48(2) MiFID; rec. 38 and art. 14 Market Abuse Directive.

[387] Art. 50, 51 and 53 MiFID.

[388] Art. 52(2) MiFID.

(future) Market Abuse Regulation requires that 'appropriate administrative measures' are taken to enforce and sanction violations of the Regulation[389], while the pending draft for a revised Market Abuse Directive (II) will require the Member States to sanction certain criminal offences with effective, proportionate and dissuasive criminal sanctions.[390] Yet, on the matter of private enforcement and actionability of the rules, however, complete silence is maintained.

Notwithstanding the lack of clear indications in the directives itself, the recurrent emphasis on investor protection and investor empowerment has led some authors to conclude that the ad hoc disclosure obligations imposed by the Market Abuse Directive[391] and the rules of conduct enacted by MiFID cannot but be intended to grant actionable rights to individual investors.[392] However, as the ECJ decision i*n Peter Paul* clarified, the mere mentioning of (investor) protective goals is not decisive to the question whether or not individual rights are granted to individual investors to enforce the rules privately.[393] Relevant from our point of view is the Court's reasoning, holding that "it does not necessarily follow either from the existence of such obligations or from the fact that the objectives pursued by those directives also include the protection of depositors that those directives seek to confer rights on depositors […]".[394] Yet with regard to MiFID, it has been observed by various commentators that the rules of conduct laid down in MiFID and Level Two MiFID Implementing Directive intervene more deeply in the private law relationship between investors and investment firms, and also have been formulated in precise and highly detailed wordings.[395] Second, other than the banking directives in *Peter Paul*, MiFID explicitly and repeatedly confirms that the rules aim to increase the level of investor protection.[396] For these reasons, this strand of literature contends that MiFID intends to provide investors with the right to privately enforce the rules of conduct vis-à-vis

[389] Art. 26 Market Abuse Regulation.

[390] Art. 5 MAD II-Proposal.

[391] As the rules and underlying rationale for the issuer disclosure obligations under the Market Abuse Directive are similar to those under the Market Abuse Regulation, the position taken by the authors on the private enforceability of these disclosure obligations most likely equally to the Market Abuse Regulation too.

[392] With respect to the Takeover Bid Directive, RINGE and HELLGARDT point out that the 'effet utile' is likely to require the possibility for allegedly aggrieved investors to file claim pursuant to breaches of the disclosure duties imposed by the Takeover Bid Directive (RINGE and HELLGARDT, 'International dimension', 29). See similarly: HELLGARDT and RINGE, 'Internationale Kapitalmarkthaftung', 808. With regard to an analysis of the Market Abuse Directive, consult: HELLGARDT, 'Europarechtliche Vorgaben', 154-168. The author concludes that the ad hoc disclosures as well as market manipulation practices within the scope of the Market Abuse Directive grant individual rights to investors. With regard to MiFID, reference can be made to TISON, 'Civil law effects', 2621-2639 for an analogous argument in the context of MiFID; and REICH, 'Interrelation between rights and duties in EU law', 150 ff.

[393] ECJ, 12 October 2004, Case C-222/02, *Peter Paul v Bundesrepublik Deutschland*, [2004] ECR I-9425. The decision in *Peter Paul* concerned a claim by bank depositors against the state for not correctly implementing the banking directives that provided for depositor protection in case of credit institution insolvency. The plaintiffs in this case had held a bank account with a German bank that received a banking license from the German banking supervisor on the condition that it would provide for a deposit guarantee for its clients. The bank repeatedly tried to join deposit a guarantee system, though failed to comply with the admission criteria. After the bank's bankruptcy, the plaintiffs found themselves excluded from the deposit guarantee and instead, were dependent on the (uncertain) dividend distribution in the bankruptcy proceedings. As the German state had neglected to correctly implement the deposit insurance guarantee regulation imposed by the banking directive. The depositors held the state liable for its failure to take adequate supervisory measures that would have prevented their loss from occurring and claimed damages for the national courts. In appeal, the court asked the ECJ to rule on the question whether the banking directive granted individuals the right to claim damages from the state for its failure to take adequate supervisory measurers in line with the banking directives to the ECJ.

[394] Case C-222/02, *v Bundesrepublik Deutschland* [2004] ECR I-9425, para. 40.

[395] REICH, 'Interrelation between rights and duties in EU law', 150-151; TISON, 'Civil law effects', 2624.

[396] Rec. (2) and (31) MiFID. See in this regard also: Case C-604/11 *Genil 48 SL v Bankinter SA, Banco Bilbao Vizcaya Argentaria SA*, Judgment of the Court of 30 May 2013, not yet reported, para. 39.

investment firms. According to this view, Member States are required to provide for effective remedial rights allowing investors to enforce the rules of conduct through the Member States' private laws.[397]

103. Assessment. – Although it is undisputed that the MiFID rules of conduct intervene to a considerable extent in private legal relationships – both in the precontractual phase as during the execution of investment services – between investment firms and investors, this observation does not naturally lead to the conclusion that MiFID intends to confer private remedial rights to individual investors in the event of breach.[398] Similarly, the fact that the Market Abuse Directive aims to increase investor confidence by rooting out market abusive practices and enhancing market transparency by means of disclosure obligations does not corroborate the argument that investors are entitled to private legal remedies in the event of breach. In line with longstanding principles in EU law, directives set the objectives for the Member States to be achieved, yet leave the manner and method to attain to these goals to the Member States' discretion, whereas the effectiveness principle requires the Member States give EU law full effect in the national legal orders.[399] More specifically, MiFID obliges the Member States to provide for a sufficient level of investor protection by implementing the duties set out in the directive and enforce the rules through administrative authorities in a dissuasive, proportionate and effective manner. Yet, MiFID does not mention an obligation to provide private actionable rights. As a result, MiFID only requires the Member States to provide for actionable private rights to the extent the objectives set out in the directive cannot be met without such rights. This is also illustrated in the Court's decision in *Peter Paul*, as the Court held that harmonization under the banking directives is restricted to what is essential, necessary and sufficient to realize its goal. Finding that the coordination of the national rules on the liability of the national authorities in respect of depositors in the event of defective supervision does not appear to be necessary to secure its goal, the Court rejects the position that investor were granted private actionable rights under the banking directives.[400] Applied to the rules of conduct in the MiFID and the reporting obligations in the Market Abuse Directive, this implies that as long as the required level of investor protection is met and investors are effectively protected in line with the requirements set out in the directives, it is of little importance whether this result is achieved through administrative, criminal or private enforcement, or a combination of those mechanisms.[401]

[397] Note that MiFID is a directive, which implies that its direct effect is limited to the vertical relation between Member States' public bodies and private parties. Even if MiFID confers individual rights on private parties, these rights are not directly enforceable against other private parties according to the traditional restrictions imposed by the direct effect-doctrine.

[398] *But:* REICH, 'Interrelation between rights and duties in EU law', 150-152, 156; TISON, 'Civil law effects', 2624, asserting that denying the (horizontal) direct effect of the rules of conduct is likely to violate the principle of effectiveness, that requires that EU law is given full effect in the national legal order.

[399] Art. 288 TFEU. See also : A. SOTIROPOULOU, *Les obligations d'information des sociétés cotées*, Bruxelles, Larcier, 2012, 492, para. 471. With regard to the principle of effectiveness, see *supra*, para. 91and the references cited in ftn. 325. See for a similar opinion also : KRUITHOF, 'Privaatrechtelijke werking', 306.

[400] ECJ, 12 October 2004, Case C-222/02, *Peter Paul v Bundesrepublik Deutschland*, [2004] ECR I-9425, 42 and 43.

[401] KRUITHOF, 'Privaatrechtelijke werking', 304-305. See also Advocate-General KOKOTT in her opinion on *Berlusconi and others*. In this opinion, the Advocate-General discussed the interpretation of art. 6 First Council Directive 68/151/EEC of 9 March 1968 (on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, *OJ* L 65/8). The case concerned a prejudicial question by an Italian court on criminal sanctions for false accounting. The First Council directive does not explicitly deals with the punishment of false accounting, but concerns the accounting disclosure obligations, which must be effectively, proportionately and dissuasively sanctioned in case of breach, according to the directive. Art. 6 of this directive particularly holds that Member States shall provide for 'appropriate penalties' in case of omissions or failures to disclose the information as required by the directive. Considering the requirements criminal sanctions should meet in this regard, the Advocate-General finds that these matters are internal matters to be dealt with under national law, as long as the sanctions are proportional, effective and

This point of view is also illustrated by a recent decision passed by the ECJ on art. 19(4) and (5) MiFID. More particularly, in its decision in *Genil*, the ECJ stated that MiFID does not require the Member States to impose (contractual) remedies following breaches (of art. 19(4) and (5) in this particular case), leaving it to the Member States to determine *whether*, and if so, which contractual consequences should be imposed for breaches, provided that the principles of equivalence and effectiveness are respected (emphasis added).[402] As a result, only to the extent the existent private remedies, or the lack thereof, would fail to guarantee equivalence and effectiveness, Member States are required to reshape their national private laws. From the perspective of investor empowerment and investor confidence, which are frequently recurring goals and rationales in EU capital market law, it may be regretted that investors are not expressly granted the right to privately enforce rules with investor protection purposes, yet to the extent the Member States achieve the objectives specified in these directives, there is no legal obligation to do so.[403]

104. Summarized, the answer to the question whether there is a right to (more effective) private legal remedies based on EU law – even when EU law has not provided for it – thus depends on whether the (national) public and private enforcement regimes, as they currently exist, succeed in ensuring the effectiveness of the rules enacted at the EU level. This leads to the conclusion that it is incorrect that privately actionable rights have been implied in these directives and can be derived from the investor protection purpose. Instead, the requirements imposed by MiFID and the Market Abuse Directive as to the existence and the scope of individual private remedial rights in national courts are to be assessed in the broader context of the national enforcement regimes, including public, private and alternative enforcement techniques.[404] It also follows from the analysis that as long as the goals stated in MiFID and the Market Abuse Directive are adequately attainted to without (adjusting or amending) private actionable rights, there is no obligation for the Member States to grant such rights or reshape their national private laws.[405]

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dissuasive. The Advocate-General particularly states that "Article 6 of the First Directive grants Member States a not inconsiderable margin of discretion in the formulation of their national systems of penalties." And: "[…] from the point of view of Community law, *there is no reason in principle why a combination of provisions from criminal, civil and administrative law should not be used* (emphasis added). The guiding principle in assessing the combined effect of such provisions must rather be the effectiveness, proportionality and dissuasiveness of penalties." Opinion of Adv-Gen., 14 October 2004, Joined Cases C-387/02, C-391/02 and C-403/02, *Berlusconi and others*, para. 121.

[402] Case C-604/11 *Genil 48 SL v Bankinter SA, Banco Bilbao Vizcaya Argentaria SA*, Judgment of the Court of 30 May 2013, not yet reported, para. 57: "It should be noted that, although Article 51 of Directive 2004/39 provides for the imposition of administrative measures or sanctions against the parties responsible for non-compliance with the provisions adopted pursuant to that directive, it does not state either that the Member States must provide for contractual consequences in the event of contracts being concluded which do not comply with the obligations under national legal provisions transposing Article 19(4) and (5) of Directive 2004/39, or what those consequences might be. In the absence of EU legislation on the point, it is for the internal legal order of each Member State to determine the contractual consequences of non-compliance with those obligations, subject to observance of the principles of equivalence and effectiveness […]". Case C-604/11 *Genil 48 SL v Bankinter SA, Banco Bilbao Vizcaya Argentaria SA*, Judgment of the Court of 30 May 2013, not yet reported, para. 57-58.

[403] KRUITHOF, 'Privaatrechtelijke werking', 308, stating that the failure to provide for harmonized private legal remedies is regrettable from a policy-perspective.

[404] For example, the impact and contribution of alternative dispute resolution and other out of court-redress mechanisms may also be taken into account in order to assess whether or not national legal orders obtain the required level of investment protection.

[405] This is also illustrated in the public consultation document regarding the MiFID revision: European Commission, Public consultation: Review of the Markets in Financial Instruments Directive (MiFID), 2010, 8 December, ec.europa.eu, 63, para. 7.2.6: "While investment firms are subject to possible administrative sanctions by the competent authorities if they infringe MiFID rules, the directive does not deal with the liability of firms towards clients in cases where infringement of MiFID rules causes damage. Thus, the conditions for such civil liability vary according to Member States' civil legal orders and may sometimes be difficult to establish. […]. Introducing a principle of civil liability of investment service providers would be essential for ensuring an equal level of investor protection in the EU". See also para. 7.2.7. for a similar point of view

As a final remark, the question whether the Member States meet the standards set out by EU law in an effective manner, can only be answered in an unambiguous and final terms by the EU courts. Considering the role EU courts may play in this debate, it is repeated that the ECJ has taken the lead to interpret and derive individual private rights of action in various areas of EU law where no such rights were expressly provided for in the legal texts. In the light of this evolution, it cannot be ruled out that the Court may decide to take a similar step in the field of European capital market law, although its recent decision in *Genil* does not give any evidence of an inclination in that direction. The Court's confined its holding in *Genil* particularly to stating that the private law effect of MiFID is an internal matter left to the Member States' discretion, be it that the principles of effectiveness and equivalence must be respected. The question if and to what extent the laws of the member states (or in this case, Spanish law in particular) meet this standard was left unanswered.[406]

C. Conclusion

105. The analysis shows that whereas some of the EU capital market law directives contain obligations to provide for private law remedies in the event of breach, such as the AIFMD, the CRA Regulation, the Prospectus and the Transparency Directive, others do not, as illustrated by MiFID and the Market Abuse Directive. In those cases where rules dealing with the private law effect of EU capital market law have been provided, it was noted that the impact on the national private laws remains nonetheless limited as many elements and conditions related to civil liability are invariably left to the discretion of the member states. Yet, even though the legislation on its face only requires the national rules to apply without setting out further requirements as to the content of the national substantive and procedural laws, the gradually developing case law generated by the EU courts has made it clear that there might be more to the obligation. More particularly, applying the court-based principles of equivalence and effectiveness, the EU courts have gone further than the legislator and scrutinize national procedural and substantive laws to ensure that the national rules give full effect to EU law. As a result, Member States are not only required to give individuals access to private remedies when EU law demands such access, but must also ensure that the remedies are *effective*. The latter obviously puts a strain on the procedural autonomy of the Member States to organize their national enforcement system through national procedural and remedial law. The obligation to provide for effective liability rules undoubtedly applies if explicit requirements for Member States to apply their national civil laws have been laid down in EU legislation, yet its impact is less clear when no such explicit rules have been provided, as is the case with MiFID and the Market Abuse Directive. As only the EU courts can unambiguously resolve the question, it remains unsettled to what extent private liability rights have been conferred on individuals by the Market Abuse Directive and MiFID. It is nonetheless clear that Member States are in any case required to ensure that directives – including the Market Abuse Directive and MiFID – take full effect in the national legal order, regardless of whether this is to be done through public and/or private enforcement mechanisms. This leaves us with the conclusion that private party liability for violations of EU capital market law is strongly dependent on the Member States' private laws. Put differently, the question whether and to what extent investors are

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expressed with regard to attaching civil liability consequences to violations of the best execution principles. For a similar argumentation and conclusion: KRUITHOF, 'Privaatrechtelijke werking', 306-307. See also: D. BUSCH, 'MiFID II: Europese aansprakelijkheid van beleggingsondernemingen', *T.F.R.* 2011, 57-58.

[406] "In the absence of EU legislation on the point, it is for the internal legal order of each Member State to determine the contractual consequences of non-compliance with those obligations, subject to observance of the principles of equivalence and effectiveness". Case C-604/11 *Genil 48 SL v Bankinter SA, Banco Bilbao Vizcaya Argentaria SA,* Judgment of the Court of 30 May 2013, not yet reported, para. 57-58.

enabled to privately enforce the (extensive) set of investor protection rules enacted at the EU level, in their national courts depends on whether the Member States provide effective remedies and actionable private rights, and is discussed in detail in the remainder of this thesis.[407]

IV. Private enforcement of EU capital market law: Conclusion

106. The main thrust of this chapter concerns the question whether private party liability within the scope of EU law emerges following violations of EU capital market law, and if so, to what extent the EU level has filled in and harmonized the conditions and consequences of such liability. The chapter started out with the main goals of enforcement, being deterrence and compensation, and discussed advantages and disadvantages of private and public enforcement structures in realizing these goals. It was concluded that depending on the circumstances, one or the other system may be better suited to enforce the law, yet overall, it seemed that both systems are often complementary. No sound and foregone conclusions have been reached with regard to capital law enforcement, however, as there is still much to be learned about enforcement structures, their impact in terms of efficiency and effectiveness in realizing the aforementioned goals of compensation and deterrence. The research into enforcement structures on both sides of the Atlantic seems to indicate however that formal public and private enforcement activity in European countries seems – generally speaking – to be considerably less intense than is the case in the US. Although one should not jump to conclusions – especially since the studies focused on formal enforcement actions carried out by one type of supervisor mostly, and did not take alternative forms of enforcement into account – studies ordered by the European Commission indicated that law enforcement in the EU Member States needs reinforcement and more harmonization, as the current systems were found to be too weak and heterogeneous, or caused inconsistencies in the level of investor protection as a result of differences in substantive law. Various steps have been taken to mitigate the concerns since the reports came out, yet most of these initiatives have been concentrated on the area of public law enforcement.

107. Notwithstanding the focus on public enforcement, an increased awareness for the role private enforcement mechanisms as a means to enhance compliance with EU legislation was observed in recent legislative initiatives as well. The increasing interest for private financial law enforcement at the EU level is not only motivated by observed weaknesses in (EU) capital market law enforcement, but is also the result of concern that the lack of harmonized liability rules may undermine the European integration goal. More particularly, finding that notable disparities between the national liability regimes exist with differences in investor protection levels across the Member States as a result, concerns have been voiced that the different liability regimes may cause legal uncertainty, which increases the overall cost of trading on EU markets, and regulatory arbitrage, which may undermine integration and the overall effectiveness of the European legal framework.[408] The report drafted by the ESMA on national prospectus liability regimes is illustrative in this regard, as well as the mapping exercise conducted by the former CESR regarding the duties and liability of UCITS depositaries. Both these reports concluded that a wide variety of liability rules apply which may foster legal uncertainty in cross-border transactions since "the diversity in the different jurisdictions could make it difficult for market participants to assess their risks and rights in accordance with the applicable prospectus

[407] See in this regard also: MOLONEY, 'Effective policy design', 425; CHEREDNYCHENKO, 'Regulation of Retail Investment Services', 417; REICH, 'Interrelation between rights and duties in EU law', 152; CHEREDNYCHENKO, 'European securities regulation', 925.

[408] See in this regard also: TISON and RAVELINGIEN, 'Roma Locuta', 254; SCHAMMO, *EU Prospectus Law*, 240.

liability regimes."[409] Yet, even though the Commission seems authorized to enact legislation aimed at harmonization of the national laws in furtherance of the single market, restraint has been displayed with regard to the harmonization of civil liability rules.

108. It was also found that the imposition of obligations at the EU level without measures ensuring its enforcement left a vacuum, or at least disparity between rights and obligations, which caused the EU courts to step in. Under the auspices of the EU courts, various doctrines have been developed to ensure that private individuals can enforce rights conferred on them by EU law in national courts against other private parties. Yet, whereas private remedies for breaches of EU law have been acknowledged in various fields of EU law already, and most notably in the field of competition and non-discrimination in the context of employment law, the impact of the EU courts on EU capital market law has remained modest. As a result, investors continue to remain highly dependent on the national liability systems when it comes to redress for violations of EU capital market law. Specifically with regard to causation, loss and available remedies, no requirements have been set other than the principle that the procedural rules applicable to claims for breaches of EU law cannot be less favorable than those applicable to breaches of national law, nor may the rules prevent the European rules from being fully effective in the national legal orders.

The next chapter examines the Member States' private liability systems within which aggrieved investors can file claim for EU law violations, discussing the general contractual and non-contractual liability systems and the specific liability regimes and statutory causes of action. Furthermore, it will also be examined throughout the next chapters whether *effective* remedies trough the Member States' national liability systems have been provided in those areas covering liability following breaches of EU capital market law, with a specific focus on the requirements of causation and loss. It will also be interesting to see whether the fragmentation in EU legislation in terms of the different requirements with regard to private enforcement is also visible in the liability rules of the Member States.

[409] ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619, 27; CESR, Mapping of duties and liabilities of UCITS depositaries, 121. See in this regard also the pending UCITS-V-Proposal, discussing the implications of the differing national liability rules.

CHAPTER III. PRIVATE ENFORCEMENT OF (EU) CAPITAL MARKET LAW –NATIONAL LEGAL FRAMEWORKS

109. The first part of the thesis concluded that to obtain redress for violations of (largely EU-originated) capital market law, aggrieved parties remain highly dependent on the Member States' national private laws. This is not to say that European capital market legislation has not interacted or influenced the Member States' private laws and private enforcement mechanisms, however. Besides a converging effect that may have taken place with regard to the rules and requirements market participants are expected to comply with[410], the promulgation of European capital market law occasionally also triggered reforms and modifications of the Member States' private liability laws. For example, some of the national prospectus liability regimes were reformed pursuant to the enactment of the Prospectus Directive and now provide for specific, tailored prospectus liability rules suited to address particular difficulties and questions that had arisen in prospectus liability cases.[411] Along similar lines, the UK enacted specific legislative provisions following the enactment of the CRA Regulation and the Transparency Directive in order to comply with EU requirements.[412] In other instances however, no specific statutory rules have been promulgated, implying that in those cases investors have remained dependent on the causes of action available to them under the general civil liability rules. This chapter aims to offer a concise overview of the causes of action available to investors to obtain redress for loss suffered following violations of capital market law. As this thesis focuses on the interpretation and application of the requirements of causation and loss and the assessment of damages in the context of investor suits, the text below will concentrate on (the requirements to obtain) compensatory damages, yet to clarify and outline the framework within which the liability rules operate, other possible remedies are also briefly discussed in this chapter.

I. Introduction: Remedies under the Member States' general liability laws

110. Under the Member States' national private laws, a range of remedies can be thought of to redress investor losses. These remedies generally include claims for damages in non-contractual and contract law, rescission or termination of contract, transactions declared null and void or not imputable to the client (in case the mandate to effectuate transactions on behalf of the client-investor has been exceeded for instance) and – in some instances – sanctions affecting the validity or enforceability of contracts may be at the investor's disposal.

A. The traditional division between non-contractual and contract law in the Member States

111. The division between contract and non-contractual law is a traditional and common feature of private law across European Member States, even though non-contractual and contractual liability regimes are intertwined to a certain degree, as is also demonstrated in case law and academic

[410] See *supra*, para. 70.

[411] For example, the transposition of the Prospectus Directive triggered reforms in the national liability regime of Spain: (Spain) SEBASTIÁN and TORTUERO, 'Prospectus liability under the Spanish Securities Market Act: a comparison between the New Spanish Regime and the US regime', 331.

[412] In response to the enactment of the Transparency Directive, the UK introduced a new s.90A FSMA, which provides for a statutory liability regime for secondary market information. See also: DAVIES, 'Davies review. Discussion paper', para. 40 ff. See also: VEIL (ed.), *European capital markets law*, 264-265. With regard to the rules on credit rating agency liability: UK CRA Liability Regulations 2013 (available at: http://www.legislation.gov.uk). See in this regard also: EDWARDS, 'CRA 3 and the liability of rating agencies', 188. See also *infra*, para. 191.

literature.[413] The interrelation between non-contractual and contract law via the concept of obligation is also reflected in the use of the general term 'liability law' in these jurisdictions to refer to the rules applicable to a breach of either non-contractual or contractual obligations. The UK common law on the other hand applies a stricter division between tort and contract law, and by extension also between the respective liability regimes.[414] A different range of causes of action to remedy investor losses may nonetheless depend on whether it concerns a claim for damages in contract or non-contractual law with different implications regarding the requirements to be met and the remedy to which an investor may be entitled, as demonstrated in this section.

B. Investor redress: compensatory damages in non-contractual liability law

112. General overview. – Even though statutory causes of action have gradually been enacted with regard to specific breaches of capital market law, general non-contractual liability law has continued to play a major role in investor litigation in many Member States. First, investors have remained dependent on general non-contractual law in cases where no specific legislative provisions have been enacted.[415] Second, even if tailored, statutory causes of action have been enacted for certain specific breaches of capital market law, these provisions often only partially substitute for general non-contractual law since various aspects, such as the concept of recoverable loss, the measurement of the damages and to a lesser extent the requirement of causation, have not always been expressly regulated by the statutory provisions. As a result, these matters often are still governed by general non-contractual liability law. The availability and contours of causes of action available to investors within the Member States' non-contractual liability laws are therefore concisely outlined in the next paragraphs.[416]

113. The legal basis to claim damages on a non-contractual liability basis in continental European legal systems is generally codified in civil codes and states that those who cause others to suffer losses as a result of their wrongful behavior are obliged to compensate for the loss.[417] Hence, to obtain

[413] M.W. HESSELINK and G.J.P. DE VRIES, *Principles of European Contract Law*, Deventer, Kluwer, 2001, 41 and references cited; C. VON BAR and U. DROBNIG, *The interaction of contract law and tort and Property Law in Europe*, Munich, Sellier-European Law Publishers, 2004, para. 71. Moreover, in some Member States the traditional division between non-contractual and contractual liability regimes has been explicitly questioned: France: G. VINEY, *Introduction à la responsabilité*, Paris, L.G.D.J., 2008 401 ff., n° 165 ff.; In Italy as well, the division has been questioned. See for instance: VON BAR and DROBNIG, *The interaction of contract law*, para. 71; See on this topic also: PH. BRUN, *Responsabilité civile extracontractuelle*, Paris, LexisNexis, 2005, 50-51, n° 88-89; and P. RÉMY-CORLAY, 'Damages, loss and the quantification of damages in the Avant-projet de réforme', J. CARTWRIGHT, S. VOGENAUER and S. WHITTAKER, *Reforming the French Law of Obligations*, Portland, Hart Publishing, 2009, 318 ff. Belgium: B. DUBUISSON, 'Responsabilité contractuelle et responsabilité aquilienne. Comparaison n'est pas raison', S. STIJNS and P. WÉRY, *De raakvlakken tussen de contractuele en de buitencontractuele aansprakelijkheid*, Brugge, Die Keure, 2010, 1-51. See on this topic also: N. JANSEN, 'The Concept of Non-Contractual Obligations: Rethinking the Divisions of Tort, Unjustified Enrichment, and Contract Law', *JETL* 2010, 16-47.

[414] *But:* A. BURROWS, *Remedies for torts and breach of contract*, New York, Oxford University Press, 2004, 7-9, questioning whether the distinction between tort and breach of contract can sensibly be maintained; See in detail on the differences and similarities between tort and contract law with regard to the measurement of damages: H. MCGREGOR, *McGregor on damages*, London Thomson Reuters, 2009, 765 ff.; J. CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, London, Sweet & Maxwell, 2012, 18-21; see also: HESSELINK and DE VRIES, *Principles of European Contract Law*, 40; and for a profound analysis in this regard: S. HARDER, *Measuring damages in the law of obligations*, Portland, Hart Publishing, 2010, 323.

[415] In France for instance, no specific legislation has been enacted to deal with liability claims following misleading issuer disclosures, both in the context of prospectuses as in the area of ad hoc and periodic disclosures. In Belgium and the Netherlands, general non-contractual liability law is applied with regard to deficient secondary market disclosures.

[416] Due to restrictions in time and volume, the discussion is kept to a minimum. References to more lengthy and detailed discussions are included in the footnotes.

[417] Belgium: art. 1382-1383 BCC; France: art. 1382-1383 FCC; The Netherlands: art. 6:95-110 DCC (art. 6:162 DCC in particular); Germany: §823 and §826 BGB; Italy: art. 2056-2059 ICC.

recovery the victim is required to establish evidence of the wrongdoer's wrongful behavior, the harm suffered and causation between those two elements. Some jurisdictions, such as Belgium and France, have codified this principle in single legislative provisions and do not define or otherwise describe the requirements of wrongful behavior, causation and damage, leaving the interpretation of these requirements to the courts. As the French and Belgian non-contractual liability rules, nor the courts have restricted the reach of the French and Belgian non-contractual liability laws to (a limited number of) protective rights as is the case in Germany and the UK, or limited the availability of causes of actions by introducing a relativity requirement as in the Netherlands and Germany, the Belgian and French non-contractual liability law systems are considered to be open non-contractual liability law systems with a distinctively broad reach.[418]

114. The Netherlands. – Similar to the French and Belgian approach, the Dutch general non-contractual liability rule in art. 6:162 DCC states that any person causing harm to another as a result of an unlawful act is liable to repair that harm. 'Unlawful acts' are to be understood as the violation of subjective rights, acts or omissions violating statutory duties, or conduct that is considered unacceptable in the light of the unwritten, common rules in society.[419] Furthermore, the third paragraph of art. 6:162 DCC declares the actor responsible for his wrongful act insofar it is due to his fault or to a cause he is accountable for by law or by generally accepted principles ('*toerekenbaarheid'*). As the phrase on the unlawfulness of unacceptable behavior in the light of the unwritten, common rules in society illustrates, the Dutch system is not as restricted as the protected right system outlined in the German rules (§823 II BGB, see below). Yet even though the principle of non-contractual liability laid down in 6:162 DCC is obviously one that allows for a broad margin of judicial interpretation[420], the Dutch system is more restricted than the Belgian of French because it requires that the legal norm violated by the tortfeasor was aimed at protecting the claimant against the harm inflicted. This limitation of non-contractual liability in Dutch law is generally referred to as the requirement of relativity ('*relativiteitsvereiste'*) and is highly similar to the German '*Schutznorm*' requirement (see below).[421] Another element to be taken into account is art. 6:98 DCC, which sets out the causation test and is usually referred to as the imputation test ('*leer van de toerekening'*).[422] In short, the imputation test implies that losses are only recoverable to the extent they have been caused by unlawful acts and insofar it is reasonable to attribute them to the tortfeasor based on the nature of the loss and the liability. Various factors can be taken into account in order to determine whether there is reasonable attribution in the sense of art. 6:98 DCC, including the foreseeability of the loss, the

[418] With regard to the French system: PH. BRUN and C. QUÉZEL-AMBRUNAZ, 'French Tort Law Facing Reform', 4 *JETL* 2013, 78.

[419] Art. 6:162 (1) DCC.

[420] Especially the assessment of conduct that is considered unacceptable in the light of the unwritten, common rules in society allows courts to employ discretion in their assessment.

[421] Art. 6:163 DCC: "Geen verplichting tot schadevergoeding bestaat, wanneer de geschonden norm niet strekt tot bescherming tegen schade zoals de benadeelde die heeft geleden". See in this regard: A.S HARTKAMP and C.H. SIEBURGH, *Mr. C. Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht, Verbintenissenrecht. De verbintenis uit de wet*, 6.IV, Deventer, Kluwer, 2011, 122, para. 129 ff. And (specifically with regard to investors) also: B. DE JONG, *Schade door misleiding op de effectenmarkt*, Nijmegen, Kluwer, 2010, 61 ff.

[422] SPIER, *Verbintenissen uit de wet en schadevergoeding*, 188 ff., paras 216-220; A.S HARTKAMP and C.H. SIEBURGH, *Mr. C. Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, 6.II, Deventer, Kluwer, 2009, para. 61 and para. 125 in particular.

nature of the liability and the nature of the loss as indicated in the provision (see also below for a discussion on the requirement of causation).[423]

115. Germany. – Contrary to the Belgian and the French system that are characterized by fairly open non-contractual liability systems, the German non-contractual liability system is based on the theory of protected rights, meaning that only those rights protected by specific causes of actions – i.e. §823 I, §823 II and §826 BGB – can give rise to compensatory damages in non-contractual liability law.[424] §823 I BGB applies following infringements of specific, enumerated rights and is not generally employed with regard to investor losses.[425] Instead, investor claims are generally based on §823 II BGB and even more so on §826 BGB.[426] §823 II BGB covers for the breach of interests protected by statutory provisions.[427] As a result, §823 II BGB requires a violated protective norm, the so-called '*Schutzgesetz'* in German law, which requires that the rule invoked by the victim aims to protect the interests that have been violated by the wrongdoing, similar to the relativity requirement that applies in the Netherlands.[428] In case it concerns intentional unlawful behavior, claims for compensatory damages in non-contractual liability law can also be grounded on §826 BGB. The notion 'unlawful' is to be interpreted by courts as intentional and against standards of proper conduct ('*boni mores'* or '*gute Sitten'*).[429] As evidence of the wrongdoer's intent is generally difficult to present, courts have relaxed the requirement of 'intent' by considering that the willfulness of the misconduct is established when there was 'knowledge' or 'awareness' of the potential harm the conduct may cause on the side of the wrongdoer.[430]

116. UK – Torts of negligence and deceit. – Other than the continental civil law systems, UK tort law has not codified its legal basis for damages. The rules governing damages in tort have instead been developed in UK courts. UK tort law is limited in scope as only the interests covered by particular torts are protected.[431] Depending on the particular tort the claim is based on, certain conditions must be met to be entitled to damages (or other remedies). The most important torts in the context of investor losses are the torts of negligence and deceit. Under the tort of deceit, claimants recover damages for

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[423] Art. 6:98 DCC: "Voor vergoeding komt slechts in aanmerking schade die in zodanig verband staat met de gebeurtenis waarop de aansprakelijkheid van de schuldenaar berust, dat zij hem, mede gezien de aard van de aansprakelijkheid en van de schade, als een gevolg van deze gebeurtenis kan worden toegerekend."

[424] See §823 I BGB, which is a general rule of fault liability. See also: VON BAR and DROBNIG, *The interaction of contract law*, para. 42; KOZIOL, *Basic questions of tort law*, 9 ff. Also drawing comparisons on the French and German tort law model: BRUN and QUÉZEL-AMBRUNAZ, 'French Tort Law', 80. The problems investors encountered in trying to obtain compensation via German tort law are to a certain extent comparable to the Italian situation. In Italy, investors can rely on the general tort law principles stated in art. 2043 Italian Civil Code ('ICC'), provided that the allegedly infringed interests or rights are protected by the law. The legal basis for investor litigation directed against issuers, company directors, auditors is subject of discussion however. See for instance: C. AMATO, 'Financial contracts and 'junk title' purchases: a matter of (in)correct information', M. KENNY, J. DEVENNEY and L. FOX O'MAHONY, *Unconscionability in European Private Financial Transactions*, Cambridge, Cambridge University Press, 2010, 316-318 and references cited.

[425] §823 I BGB protects specific interests, such as "life, body, health, freedom, property or other right" (translation taken from: U. MAGNUS and K. BITTERICH, Tort and Regulatory Law in Germany, W.H. VAN BOOM, M. LUKAS and C. KISSLING, *Tort and Regulatory Law*, Tort and Insurance Law, 19, New York, Wien, Springer Vienna, 2007, 115).

[426] O. PALANDT (ed.), *Bürgerliches Gesetzbuch*, München, Beck, 2006, §823, para. 2-22.

[427] *Ibid.*, §823, para. 56-72

[428] *Ibid.*, §823, para. 56.

[429] *Ibid.*, 1278 ff., §826. See also: B.S. MARKESINIS, *German Law of Torts*, Oxford, Hart Publishing, 2002, 889; VON BAR and DROBNIG, *The interaction of contract law*, para. 42.

[430] MARKESINIS, *German Law of Torts*, 889; J. VON HEIN, 'Culpa in contrahendo', J. BASEDOW, K.J. HOPT and R. ZIMMERMANN, *The Max Planck Encyclopedia of European Private Law*, Vol. I, Oxford, Oxford University Press, 2012, 430.

[431] See for instance: J. GORDLEY, *Foundations of private law: property, tort, contract, unjust enrichment*, Oxford, New York, Oxford University Press, 2006, 166 ff.

losses suffered by relying and acting on a statement made to him with fraudulent intent on the side of the tortfeasor. Fraudulent intent requires that the defendant knew the statement was untrue or if he did not care whether there was truth in the statement or not.[432] The representation needs to be addressed to the claimant, although it is not required that the claimant to be specifically identified as the addressee.[433] The defendant must have intended the claimant to rely on the statement, whilst the claimant must indeed have relied on the false information.[434] With regard to the remedy, the claimant is entitled to damages that compensate for the entire loss caused by the claimant's reliance on the fraudulent statement or conduct. In case of securities transactions or investments induced by fraudulent statements or behavior, this implies that claimants are entitled to damages for the entire loss caused because of entering into the transaction, being the difference between what has been paid and what has been received following the transaction one was induced to enter into as a result of the fraud.[435] In *Smith New Court Securities* for instance, the claimant had been induced by fraudulent misrepresentations to purchase shares in a company.[436] As it was later revealed that a major fraud had been committed by the company, the shares plunged and the claimant made a considerable loss on the subsequent sale of the shares. Filing for damages in deceit, the claimant recovered damages based on the difference between the initial purchase price paid and the sale price he received upon selling after the fraud had been revealed, as the court held that the entire loss had been caused by the claimant's initial consent to enter into the transaction because of his reliance on the misrepresentations, notwithstanding the fact that much of that loss had been caused by unrelated elements apart from the misrepresentations.[437] A more restrictive approach is noted to claims filed for damages following negligent misrepresentations.

117. Restrictive approach towards economic losses in negligence (UK). – Recovery for losses caused by negligent misstatements in tort have traditionally been restricted in the UK, mostly because of a general reluctance to offer compensation for losses with an exclusive financial or pecuniary character (economic loss), and in that sense distinct from personal, physical injury or damage to property.[438] The restrictive stance towards the compensation of losses of an exclusive financial nature outside contractual or fiduciary relationships has been found to lie in the mix of historical tradition, or historical accident according to some commentators, the urge to limit (access to) damages in order to avoid opening the so-called floodgates of litigation and a matter of public policy.[439] The access to

[432] Pasley v. Freeman (1789) 3 T.R. 51; Derry v. Peek L.R. 14 App. Cass. 337; FoodCo UK LLP (t/a Muffin Break) v Henry Boot Developments Ltd (2010) EWHC 358 (Ch); Akerhielm v De Mare (1959) A.C. 789.

[433] J.F. CLERK, W.H.B. LINDSELL, A.M. DUGDALE and D. ALEXANDER, *Clerk and Lindsell on torts*, London, Sweet & Maxwell, 2000, 15-28, and references cited.

[434] *Peek v. Gurney* LR 6 HL 377; Commercial Banking of Sydney v. R.H. Brown & Co. (1972) 2 Lloyd's Rep. 360.

[435] "The complaint of the plaintiff is that he has been induced by a suppression in the prospectus, to which the statute attaches the character of fraud, to take shares in an undertaking, which, but for this suppression, he would not have joined, and which has turned out to be worthless. […] His grievance is not that he has paid too high a price, but that he has been induced to take shares which, but for the fraud, he would not have taken at all. He is, therefore, in the position of a person who has been induced to take shares and pay the price of them by a fraudulent misrepresentation, and he is, therefore, entitled to recover such damages as have resulted to him from taking such shares. If this damage extends to the entire price paid for the shares he is entitled to recover it", Twycross v. Grant, (1877) 2 C.P.D. 469 CA, at 543. See also: McConnell v. Wright, (1903) 1 Ch. 564 CA; Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254.

[436] Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254. See also: CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 217 ff.

[437] In this case, the shares had plunged following the discovery of a major fraud committed by a third party, in which the defendant had played no part.

[438] A. HUDSON, *Securities Law*, London Sweet & Maxwell, 2008, 24-32; KALLS, 'Recent developments', 78 ff.

[439] In the words of the American judge CARDOZO, tort law is reluctant towards the compensation of economic losses as he fears that "liability in an indeterminate amount for an indeterminate time to an indeterminate class" would emerge as a result,

redress for economic losses suffered as a result of negligent misstatements in tort has particularly been restricted by requiring that the defendant owed a duty of care to the claimant not to cause loss. Over time however, the narrow and strict position proved unsustainable, causing courts to relax their traditional objections and restrictions on an ad hoc basis.[440]

A first relaxation, decided in the landmark decision *Hedley Byrne v. Heller and Partners Ltd* and refined by later decisions, held that in cases where economic losses had been suffered due to negligent misstatements, the loss could be recovered under the tort of negligence if '*necessary proximity*' exists between the representor and the representee.[441] Necessary proximity more particularly exists in cases where the representor intended the claimant, who sought information and/or advice from the defendant, to rely on the statement(s). Whether the required intention was present can be derived from the fact that the defendant expressly stated his intent, or when there is no such express indication, when the claimant could reasonably rely on the statements in the light of the circumstances while the defendant knew, or was ought to know, that the claimant would do so.[442] In those cases where this kind of proximity exists, there is an 'assumption of responsibility' establishing a 'special relationship' between the parties which causes the defendant to take reasonable care not to cause loss to the claimant.[443] For example, in *Hedley Byrne*, advertising agents had requested their bankers to examine and advise on the financial stability of a client. The bankers reported a solid financial situation, causing the advertising agents to take up a business relation with the client, which caused them to

thereby referring to the fear of courts for the flood of claims financial losses can cause; see C.J. CARDOZO in *Ultramares Corp. v. Touche* 255 N.Y. Rep. 170 at 179 (1931); 174 N.E. Rep. 441 at 444 (1931). See for instance with regard to the UK: *SCM (UK) Ltd v. W.J. Whittall & Son Ltd*, 1 QB 337, at 344. As mentioned, contracts are considered a well suited and better instrument to protect financial interests than tort law, as economic relationships are usually created rather than imposed and therefore enable the parties to lay down their interests and protection thereof in a contact (see CLERK, LINDSELL, DUGDALE and ALEXANDER, *Torts*, 7-87). See also: MCGREGOR, *McGregor on damages*, 2-042. See also: J. STAPLETON, 'Duty of care and economic loss: a wider agenda', 107 *LQR*, 1991, (249) 253 ff. With regard to Germany: J. GORDLEY, 'The rule against recovery in negligence for pure economic loss: an historical accident?', M. BUSSANI & V.V PALMER, *Pure economic loss in Europe*, Cambridge, Cambridge University Press, 2003, 42 ff.; C. VON BAR, 'Liability for information and opinions causing pure economic loss to third parties: a comparison of English and German Law', B.S. MARKESINIS, *The Gradual Convergence*, Oxford, Clarendon Press, 1994, 98-127; H. SCHÄFER, 'Liability of experts for pure economic losses, an economic analysis with special reference to German cases', 2001, available at SSRN: http://papers.ssrn.com/, 3; R. BERNSTEIN, *Economic Loss*, London, Sweet & Maxwell, 1998, 11; GORDLEY, *Foundations of private law*, 270-271.

440 M. MACGRATH, 'The recovery of Pure Economic Loss in Negligence - An Emerging Dichotomy', 5 *Oxford J. Legal Studies* 1985, n°3, 350-377; M. BUSSANI and V.V. PALMER, 'The liability regimes of Europe - their façades and interiors', M. BUSSANI and V.V. PALMER, *Pure economic loss in Europe*, Cambridge, Cambridge University Press, 2003, 140 ff. The expansion of the notion of contract to cover for these losses, as happened in Germany, was impossible under UK law due to the doctrines of privity and consideration in the UK. See on this: Lord Devlin in *Hedley Byrne*: "As a problem it is a by-product of the doctrine of consideration. If the respondents had made a nominal charge for the reference, the problem would not exist. If it were possible in English law to construct a contract without consideration, the problem would move at once out of the first and general phase into the particular; and the question would be, not whether on the facts of the case there was a special relationship, but whether on the facts of the case there was a contract.", *Hedley Byrne v. Heller and Partners Ltd*, AC 465, 525-526, see also: S. BANAKAS, 'Liability for Incorrect Financial Information: Theory and Practice in a General Clause System and in a Protected Interests System', iss. 7 *ERPL*, 1999, (261) 282; and: MARKESINIS, *German Law of Torts*, 57 ff.; VON BAR, 'Liability for information and opinions', 101, 110-111; C. VAN DAM, *European Tort Law*, New York, Oxford University Press, 2006, 175, para. 714.

441 *Hedley Byrne* & Co Ltd v Heller & Partners Ltd (1964) AC 465. See also: *Possfund Custiodian Trustee Ltd v. Diamond*, where Lightman summarizes this holding as following: "a cause of action […] enabling the recovery of damages in respect of a negligent misrepresentation occasioning damage and loss [exists] where the necessary proximity exists between the representor and representee." (*Possfund Custiodian Trustee Ltd v. Diamond* (1996) 1. W.L.R. 1351, at 1359). The test developed in *Hedley Byrne* was also discussed and refined in the prospectus case *Caparo*, decided by the House of Lords in 1990 (*Caparo industries Plc v. Dickman* (1990) 2 A.C. 605 HL); see also: HUDSON, *Securities Law*, 616 ff.; C.A. WITTING, 'Compensation for pure economic loss from a common lawyer's perspective', W.H. VAN BOOM, H. KOZIOL and C.A. WITTING, *Pure Economic Loss*, Wien, Springer, 2004, 133; T.M.C. ARONS, *Cross-border Enforcement of Listed Companies Duties to Inform*, Kluwer, 2012, 188-189.

442 CLERK, LINDSELL, DUGDALE and ALEXANDER, *Torts*, 7-88 ff.

443 Idem.

suffer a loss as the client went into liquidation. The advertising agents brought an action against the bankers for the losses suffered by proceeding business with the client in reliance on the statement on their solid financial position. As any responsibility on the part of the bank for the statements on the client's financial position had been excluded by a disclaimer, the House of Lords concluded that the defendants had not assumed responsibility for the statements and could not be held liable.[444]

Although the House of Lords thus relaxed its stance on the recoverability of economic losses under the tort of negligence, the conditions set to obtain redress are not easily met as it is often difficult to establish that the required proximity between investors and the persons either drafting financial information documents or bearing responsibility for them, such as issuers, directors, accountants etc., exists. The decision in *Caparo* for instance clarifies the difficulties investors typically encounter in trying to obtain redress in within the tort of negligence.[445] *Caparo* involved a claim for negligent misrepresentation in a company's annual accounts prepared by auditors on request of the issuing company.[446] The claimants in this case were investors who had allegedly relied on the (incorrect) annual accounts to purchase the company's securities, only to find out that the company was worthless afterwards. Suing the auditors for the false statements on which they had allegedly relied in deciding to invest, the court rejected the claim, stating that the auditors did not owe a duty of care to the purchasers of the shares because the rules governing audit and certification of the annual accounts are aimed at allowing shareholders to exercise control on the board, yet not to facilitate investment decisions or attract new or additional investments from shareholders. As a result, the defendants, i.e. the auditors, in this case did not assume any responsibility for the accuracy of the information vis-à-vis the claimant who relied on the information to make an investment decision. In order to be recoverable, a relation of sufficient proximity – giving rise to a duty of care – between the parties was needed, which *Caparo* failed to establish.[447] Another example employing a similar line of reasoning is the court decision in *Al-Nakib*, which involved investors who purchased securities following an allegedly misleading prospectus.[448] Finding that the issuance of a prospectus implied that the defendants, being the directors of the issuing company, had assumed liability for the prospectus vis-à-vis initial subscribers, yet not vis-à-vis investors who had purchased the securities in the aftermarket as the claimant had done, the court rejected the claim for no duty of care had been established. Although the holding in the *Al-Nakib* has been put to doubt in a subsequent decision in *Possfund*, which held that market practices have changed over time and that investors in aftermarket purchases should be allowed to rely on the trustworthiness of the information[449], these examples nonetheless show that

[444] *Hedley Byrne* & Co Ltd v Heller & Partners Ltd (1964) AC 465. HUDSON, *Securities Law*, 617, para. 24-34 ff.

[445] Caparo industries Plc v. Dickman (1990) 2 A.C. 605 HL. See on this decision also: CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 257, para. 6.14 ff

[446] Caparo industries Plc v. Dickman (1990) 2 A.C. 605 HL.

[447] The decision in *Caparo* further clarified that in order to establish a relation of proximity, it is required (1) that the loss to the claimant was a reasonably foreseeable consequence of what the defendant did or failed to do; (2) that the relationship between the parties was one of sufficient proximity; and (3) that in all the circumstances it is fair, just and reasonable to impose a duty of care on the defendant towards the claimant." Only in case these three requirements are met, the claimant is entitled to damages in tort for negligent misrepresentations. The test was subsequently confirmed in other cases, such as Customs & Excise Commissioners v. Barclays Bank Plc (2006) UKHL 28; Arrowhead Capital Finance Ltd (In Liquidation) v KPMG LLP (2012) EWCH 1801 (Comm); Al *Nakib* Investments (Jersey) Ltd. v. *Longcroft* (1990) 1 W. L.R.1390. 54.

[448] *Al Nakib* Investments (Jersey) Ltd. v. *Longcroft* (1990) 1 WLR 1390. More extensively: HUDSON, *Securities Law*, 623, para. 24-46; ARONS, *Cross-border Enforcement*, 195.

[449] Possfund Custodian Trustee Ltd v Diamond (1996) 1 WLR 1351. In *Possfund v. Diamond*, the claimant had purchased securities following an allegedly misleading prospectus, drafted in connection with the flotation of shares on the unlisted securities market. The claimants subscribed to the issuance and subsequently purchased additional lots in the aftermarket. Holding that market practices had changed over time and that current prospectuses also aim to inform and encourage aftermarket purchasers, the court decided that investors in aftermarket purchases should be allowed to rely on the

investors who suffered losses because of negligent misstatements may still encounter substantial difficulties in trying to obtain relief in tort as a result of the requirement of a duty of care owed to them by the defendant(s). Besides the requirement of necessary proximity, the approach towards recoverable loss under the tort of deceit differs considerably from the approach employed under the tort of deceit. Under the tort of deceit, all losses resulting from the fraud are deemed recoverable, whereas certain restrictions apply when losses are claimed under the tort of negligence. As discussed further below, recoverable loss in the tort of deceit is not limited by requirements of foreseeability, remoteness, the SAAMCO-doctrine.[450]

C. Investor redress: contractual remedies

118. A wide range of remedies may apply for breach of contract and may be aimed at either remedying the loss incurred because of the breach, or enforcing the contract, for instance by means of injunctions or specific performance. As investor losses will generally focus on sanctions aimed at remedying the loss incurred, these latter remedies will not be discussed here. Instead, we focus on rescission of contract, compensatory damages, and remedies that render the contract null or void, or declare certain transactions not imputable to the client (in case the mandate to effectuate transactions on behalf of the client-investor has been exceeded for instance). Contractual remedies in the context of investor suits mostly concern suits for defective investor services and may be filed following complaints on improper diversification of investments, recommendations or advice unsuitable in the light of the investor's objectives and profile, etc.

1. Damages

119. Damages for breach of contract are conditional upon loss suffered by one of the parties to the contract as a result of the breach. The objective of the contractual remedy is generally to put the claimant in the same financial position as that in which he would have been if the contract had been correctly executed.[451] In most jurisdictions, damages in contract are therefore considered to redress both the actual damage ('*damnum emergens'*) as the lost profits ('*lucrum cessans'*), similar to the tort measure of damages in other words.[452] Damages are often awarded in combination with other contractual remedies, such as termination or rescission of the contract and aim to redress loss that has

trustworthiness of the information as investors directly purchasing through the share issuance. The decision in *Possfund* is a departure from established case law, and even though positively reacted to in the literature, it remains to be seen whether this change in course will be confirmed and upheld. See in this regard: A. HUDSON, *The Law of Finance*, London, Sweet & Maxwell, 2009, 1067; HUDSON, *Securities Law*, 590, para. 25-30; P. DAVIES, *Principles of Modern Company Law*, London, Sweet & Maxwell, 2008 para. 25-38; J. COUSINS and A. CHARMAN, 'Misrepresentation on bond issues: liability in the secondary market', *B.J.I.B.& F.L.* , January 2011, 19.

[450] See *infra*: paras. 149, 151, 154 and 263.

[451] In France and Belgium, the damages awarded according to art. 1149 FCC and BCC respectively. See also: (Belgium) D. ROGER and M. SALMON, 'Réflexions relatives à la responsabilité contractuelle des gérants de fortune et des conseillers en placements', *JT*, 1998, 400; M.-D. WEINBERGER, *Gestion de portefeuille et conseil en investissement: aspects contractuels et de responsabilités avant et après MiFID*, Waterloo, Kluwer, 2008, 160-161. (France) BRUN, *Responsabilité*, 130; and the UK: H. BEALE, A.S HARTKAMP, H. KÖTZ and D. TALLON (eds.), *Contract Law*, Oxford, Hart Publishing, 2002, 815; CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 8-27; HUDSON, *Securities Law*, 665. See with regard to the Netherlands: A.S HARTKAMP, *Mr. C. Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht. De verbintenis in het algemeen*, 6-1, Deventer, Kluwer, 2004 333, para. 413. From a comparative point of view: WURMNEST, 'Damages', 446. See also: art. 9:502 PECL, stating that "[t]he general measure of damages is such sum as will put the aggrieved party as nearly as possible into the position in which it would have been if the contract had been duly performed. Such damages cover the loss which the aggrieved party has suffered and the gain of which it has been deprived."

[452] Idem.

not been remedied by means of the termination or rescission of the contract. Obviously, in order to be entitled to damages in contract, a contractual relationship with the defendant is required, which is often the case in the context of the provision of financial services, e.g. when contracts for financial advice, asset management or order execution have been concluded.

2. Annulment, invalidity or unenforceability of contracts or transactions

a. Violation of mandatory rules affecting the validity or enforceability of the contract or transaction

120. Contracts can be declared void or null based on various legal grounds in the Member States. In various Member States, violations of rules of public law nature cause contract(s) concluded by the violator in transgression of those rules, to be void and null as a matter of principle.[453] Reference can be made to the Dutch art. 3:40 BW for instance, which states that juridical acts ('*rechtshandeling'*) performed in violation of a mandatory rule, public order law and public moral is void or voidable.[454] According to Belgian law, contracts contrary to public order law ('*openbare orde*') cannot resort consequences in the national legal order and are to be declared null and void.[455] With regard to German law, it is noted that according to §138 I BGB, transactions are void if they violate 'good morals' ('*gute Sitten'*).[456] Furthermore, §134 BGB holds that legal transactions offending statutory prohibitions are void unless another intention can be inferred from the statute at matter.[457]

121. In addition to the aforementioned rules, specific statutory provisions may state that, in certain circumstances and when the conditions have been met, contracts are unenforceable or void and null.[458] Notable examples of this kind or regulation can be found in the UK and in Belgium with regard to financial services contracts concluded by non-authorized persons who thereby violate prudential financial regulation that requires authorization prior to carrying out these regulated activities. According to UK financial regulation (s.26 and s.27 FSMA), carrying out a regulated activity in contravention of the rules on (prior) authorization, render contracts concluded by this person unenforceable against the counterpart.[459] The other party is entitled to the money or other property paid or transferred under the agreement and compensation for the loss sustained as a result of that

[453] See on this topic in the context of financial law also: (comparative) TISON, 'Civil law effects', 2625-2630; (the Netherlands) D. BUSCH and L. SILVERENTAND, 'The Netherlands', D. BUSCH and D.A. DE MOTT, *Liability of asset managers*, Oxford, OUP, 2012, 210-211; (Belgium) F. RAVELINGIEN, Privaatrechtelijke handhaving van informatieverplichtingen in het kapitaalmarktrecht, 2011, diss. (unpublished), 114.

[454] To the extent the juridical act is multilateral (for instance a contract), the act is only voidable and not per se void if the violated rule aimed to protect only one of the parties involved. See extensively on ar. 3:40, its scope and meaning: A.S HARTKAMP, *Mr. C. Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht. Algemene leer der overeenkomsten*, 4.II, Deventer, Kluwer, 2005, 241, para. 242 ff.; S.C.J.J. KORTMANN and B.F.L.M. SCHIM, 'De (on)aantastbaarheid van de met Wft strijdige rechtshandelingen', D. BUSCH, *Onderneming en financieel toezicht*, Deventer, Kluwer, 2007, 583-597.

[455] A. VAN OEVELEN, B. CATTOIR, A. COLPAERT, M. VAN LOON, R. VINCKX and L. VAN VALKENBORGH, 'De nietigheid van overeenkomsten wegens strijdigheid met de openbare orde of de goede zeden: algemene beginselen en een grondslagenonderzoek', *TPR* 2011, afl. 4, 1355. See also: KRUITHOF, 'Privaatrechtelijke werking', 317 ff.

[456] More extensively: MARKESINIS, *German Law of Torts*, 175 ff.

[457] Idem.

[458] UK: s.26 and s.27 FSMA.

[459] Both s.26 and s.27 FSMA exclude banking activities from their scope. See more extensively on the scope of s.26 and s.27 FSMA: J. RUSSEN, *Financial services: authorization, supervision, and enforcement*, Oxford, New York, Oxford University Press, 2006 120, para. 5.08; L. VAN SETTEN, 'England and Wales', D. BUSCH and D.A. DE MOTT, *Liability of Asset Managers*, Oxford, OUP, 2012, para. 11.111 ff.

transfer. The sanction of unenforceability does not apply to other breaches of FSMA, such as a violation of the rules of conduct for instance.[460] Instead a right to claim damages for those violations is laid down in s.138D FSMA.[461]

122. In Belgium on the other hand, contracts concluded by unauthorized investment firms offering investment services can be declared void and null at the request of investors who are party to the contract.[462] The Belgian law does not only provide for the annulment of investment services contracts however, but also declares the subscription to financial instruments of undertakings for collective investment in transferable securities (UCITS) without the required authorization to carry out its business, or without an authorized management company, null and void.[463] A similar nullity sanction applies to subscriptions to or purchases of financial instruments when these instruments have been publicly offered without a prospectus or without prior approval of the prospectus or other information (including advertisements) relating to the public offering by the competent authority.[464] The same goes for subscriptions or purchases related to open-ended UCITS in absence of prior approval of the key investor information document.[465] It is noted that the sanction of annulment is only prescribed in situations in which public offers were launched without (duly approved) prospectuses and key investor information documents, yet not in cases where the information as such turns out incomplete, inaccurate or otherwise misleading.[466]

123. In the Netherlands on the other hand, a different approach is employed towards financial service contracts and financial transactions carried out in contravention of mandatory and/or prudential financial regulation. Considering that annulment of financial services contracts and financial transactions may turn out complex and difficult in some cases, an exception to the general rule in art. 3:40 DCC has been created. More particularly art. 1:23 Wft clarifies that unless an explicit statutory basis to that end is provided, acts performed in violation of the Act on Financial Supervision do not render that act void or voidable.[467] As a result, investors (or other parties) cannot claim the annulment of transactions or contracts for violation of mandatory rules – including prudential, organizational and conduct of business rules – laid down in the Act on Financial Supervision. Instead, claims for damages are possible, provided that the requirements are met. It should be noted however that art. 1:23 Wft has a limited scope and does not apply to claims based on the violation of public order law, nor does it

[460] S.138E (2) FSMA (formerly s. 151(2) FSMA).

[461] S.138D FSMA only provides a cause of action for breach to ‘private persons’.

[462] Art. 86ter Law of 2 August 2002 on the supervision of the financial sector and on financial services as amended by the law of 30 July 2013: Wet tot versterking van de bescherming van de afnemers van financiële producten en diensten alsook van de bevoegdheden van de Autoriteit voor Financiële Diensten en Markten en houdende diverse bepalingen, *BS* 30 August 2013 (hereinafter: ‘Law on Financial Supervision’).

[463] Art. 86*ter*, §1, 1° and 2° Law on Financial Supervision.

[464] Art. 68*ter*, §1, 1° and 2° Law of 16 June 2006 on the public offering of financial instruments and admission to a regulated market, *BS* 21 June 2006 (‘Prospectus Act’).

[465] Art. 285*bis*, §1 Royal Decree of 3 August 2012 on certain forms of collective management of investment portfolios, *BS* 19 October 2012.

[466] On the possibility and effect of reversing securities purchases pursuant to deficient prospectus information according to Belgian law, see also: RAVELINGIEN, Privaatrechtelijke handhaving, 158-164. Note that this analysis examines the situation as it stood prior to the enactment of Art. 68*ter* Prospectus Act.

[467] Extensively in the context of asset management: BUSCH and SILVERENTAND, 'The Netherlands', para. 7.56 ff., and 7.186; see also: W.H. VAN BOOM, 'Financiële toezichtwetgeving en nietige overeenkomsten', *Vermogensrechtelijke analyses*, 2006, nr. 15-36; TISON, 'Civil law effects', 2626-2627. For examples: HR, 8 October 2010, LJN BM9615, *JOR* 2010/345; Rb Rotterdam 7 March 2012, LJN BW0387, *JOR* 2012/148; Rb Amsterdam, 10 September 2008, LJN BH2964, *JOR* 2009/71.

preclude claims for annulment based on deficiencies of consent to the contract or transaction, such as error ('*dwaling'*) or fraud ('*bedrog'*).[468]

124. Other Member States have taken a less clear position on the matter.[469] Authoritative case law in Luxembourg and Germany for instance has taken the position that contracts or transactions effectuated pursuant to such contracts are not per se null or invalid when concluded with an unauthorized entity.[470] According to German law on the other hand, regulated market participants who operate unauthorized might be subject to civil sanctions, including damages and/or unenforceability of the contracts concluded.[471] Yet in France, the French Supreme Court handed down a decision holding that a contract concluded between an unlicensed asset manager and his client was null and void as the purpose of the contract, being the provision of unlicensed services contrary to the law, is illegal.[472] In an earlier decision on the matter, however, a different position was taken by the French Supreme Court.[473] In case organizational or prudential provisions other than the rules on authorization have been violated, national courts display more reluctance to attach a nullity sanction to the violation.[474]

[468] A statement to this end was included in the drafting of the statute (consult: *Kamerstukken II*, 2005/06, 29 708, nr. 19, p. 393). See also: BUSCH and SILVERENTAND, 'The Netherlands', para. 7.183-184 ff.

[469] TISON, 'Civil law effects', 2627 and references cited. See with regard to Luxembourg for instance: I. RIASSETTO and J.-F. RICHARD, 'Luxembourg', D. BUSCH and D.A. DE MOTT, *Liability of asset managers*, Oxford, OUP, 2012, 194, para. 6.125 in particular.

[470] With regard to Germany, see for instance: M. CASPER and C. ALTGEN, 'Germany', D. BUSCH and D.A. DE MOTT, *Liability of asset managers*, Oxford, OUP, 2012, (95) 131, para. 4.146. Luxembourg: RIASSETTO and RICHARD, 'Luxembourg', paras. 6.124-125.

[471] In a case litigated before the German Supreme Court years ago, it was upheld that a contract concluded between an asset manager and his client could not be considered void even though the asset manager wrongfully declared he was licensed by the German supervisor. For examples, see: BGH, *WM* 1978, 1268, *WM* 1972, 853. See also: SCHÄFER, H.-P. SCHWINTOWSKI and F.A. SCHÄFER, *Bankrecht*, Köln, Heymanns, 2004, §19, para. 25. More recently however, the matter was brought before the *Bundesgerichtshof*, involving investors who had invested money via (silent) partnership contracts, since this kind of construction was subject to favorable tax treatment. '*Göttinger Gruppe'*, a company specialized in these activities, offered access to this kind of investment constructions to thousands of investors. Pursuant to a change in the applicable legislation however, the activities became considered a regulated activity requiring authorization under §32 KWG, contrary to what was the case before the reform. Since the company did not obtain an authorization and thus offered these investment services on an unauthorized basis for several years, the company was sued by an investor who suffered losses as a result of these investments. Confronted with the question whether the contracts closed after the authorization requirement took effect were invalid as a consequence of the unauthorized character of the activity, or whether the claims could only result in compensatory damages, the *Bundesgerichtshof* held that the contracts were valid. Despite the validity of the contract, the investors were still granted the right to terminate the contract and demand reimbursement of the invested amounts of money. BGH, 21 March 2005, II ZR 149/03, *NJW-RR* 2004, 1407; II ZR 124/03, II ZR 140/03, II ZR 180/03 and II ZR 310/03; the decisions are also available at: http://juris.bundesgerichtshof.de. See also: F. BULTMANN, O. HOEPNER and P. LISCHKE, *Anlegerschutzrecht*, München, Beck, 2009, 236-239, paras 1044 ff., paras 1052 ff.

[472] Cass., comm., 4 November 2008, discussed in COURET, GOUTAY and ZABALA, 'France', para. 3.138.

[473] Cass., comm., 4 March 2005, Jurisdata 2005-027413. See also: T. BONNEAU and F. DRUMMOND, *Droit des marchés financiers*, Paris, Economica, 2010, 468, para. 341.

[474] Some Italian courts were nevertheless found to have declared investment contracts void pursuant to the violation to provide for a written contract. PERRONE and VALENTE, 'Investor protection in Italy', 39, references cited in ftn. 31. See on this topic also: G. GIUDICI and P. BET, 'Italy', D. BUSCH and D.A. DEMOTT, *Liability of asset managers*, Oxford, OUP, 2012, 149, para. 5.58-5.59 and p. 158, para. 5.111-5.113. The absence of written contracts, contrary to (mandatory) regulation requiring contracts in writing, or violation of the rules of conduct have caused Belgian courts to declare financial services contracts void and null too in some instances. Brussel, 23 September 2010, *TBH* 2012, afl. 4, 357, with ann. by O. STEVENS; see also: Rb. Brussel, 23 September 2004, *TBH* 2006/1, 125; these decisions hold that the lack of a written agreement in the context of asset management and the failure on the side of the bank to gather adequate information on the objectives of the investor-client renders the contracts at matter null and void. *But:* considering annulment of contract following a breach of the rules of conduct disproportionate and without clear legal ground: Kh. Brussel, 9 February 2011, *J.T.*, 2011, n° 6438, 403 with annotation. See on this topic also: KRUITHOF, 'Privaatrechtelijke werking', 315 ff. See with regard to the sanction of annulment for violating the requirement to have a written investment contract also: S. DELAEY, *De contractuele verhouding inzake portefeuillebeheer: op de wip tussen MiFID en privaatrecht*, Antwerpen, Intersentia, 2010, 21-23, nr. 22; WEINBERGER, *Gestion de portefeuille*, 92 ff.

b. Defects of consent affecting the validity of contracts

125. As a general principle, a contract is based on the agreement of the parties to the contract. To the extent that the agreement of one of the contract parties to enter into the contract was affected by mistake (‘*erreur’*, ‘*dwaling’*, ‘*Irrtum*’) or fraud (‘*dol’*, ‘*bedrog’*, ‘*Täuschung*’), or undue influence exerted by one of the parties, contracts can be declared invalid in most European systems, although major differences have been reported between the legal systems with regard to the concepts and doctrines employed in this regard.[475] To the extent the loss is not entirely remedied by the annulment, claimants can demand compensatory damages, for instance when their mistake or misunderstanding is the result of other party’s negligence or fraudulent intent.[476] Consequent to the annulment or invalidity of the contract, the parties are to be placed in the situation as if the contract had not been entered into, yet the precise meaning of recovery in this context depends on the rules applicable.[477] It was already mentioned that the consequences of nullity – and often associated with that, restitution – have caused courts to act with caution in some instances.[478] In a decision handed down by the Brussels commercial court for instance, it was ruled that the annulment of a contract concerning investment advice following the violation of several rules of conduct was disproportional in the light of the consequences of the remedy and the nature of the violations.[479]

c. Assessment

[475] See for this conclusion: J. CARTWRIGHT, 'Defects of consent in contract law', A.S HARTKAMP, M. HESSELINK, E. HONDIUS, C. MAK and E. DU PERRON, *Towards a European Civil Code*, Alphen aan den Rijn, Wolters Kluwer, 2011, 537; and: O.O. CHEREDNYCHENKO, 'Conceptualising Unconscionability in the Context of Risky Financial Transactions: How to Converge Public and Private Law Approaches?’, M. KENNY, J. DEVENNEY and L. FOX O'MAHONY, *Unconscionability In European Private Financial Transactions: Protecting The Vulnerable*, Cambridge, Cambridge University Press, 2010, 246. See also: W. ERNST, 'Mistake', J. BASEDOW, K.J. HOPT and R. ZIMMERMANN, *The Max Planck encyclopedia of European private law*, Vol. II, Oxford, Oxford University Press, 2012, 1175. See also particularly with regard to Germany: B.S. MARKESINIS, W. LORENZ & G. DANNEMANN, *The German law of obligations, Volume I. The Law of contracts and restitution*, New York Oxford University Press, 1997, 195 ff.; H.G. BAMBERGER, 'Anlageberatung', P. DERLEDER, K.-O. KNOPS and H.G. BAMBERGER, *Handbuch zum deutschen und europaïschen bankrecht*, Berlin, Springer, 2009, 1417, para. 25. With regard to Belgium: 1117 BCC. See also: S. STIJNS, *‘De sanctionering van de wilsgebreken’*, R. VAN RANSBEECK, *Wilsgebreken*, Brugge, Die Keure, 2006, 130-168; WEINBERGER, *Gestion de portefeuille*, para. 197; RAVELINGIEN, Privaatrechtelijke handhaving, 120 ff.; KRUITHOF, 'Privaatrechtelijke remedies', 165. The Netherlands: art. 6:228 BW. See also: A.S HARTKAMP, *Mr. C. Asser’s handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht. Algemeen overeenkomstenrecht,* 6-III, Deventer, Kluwer, 2010, 179, para. 218; K.J.O. JANSEN, 'Aansprakelijkheid voor onjuiste informatieverstrekking', *NTBR* 2013, nr. 7, 55. UK: HUDSON, *Securities Law*, 668 ff.; CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 577. Austria: §871 ABGB, P. BYDLINSKI, 'Die Irrtumsanfechtung von Spekulations- und Vermögensanlagegeschäften', 58 *ÖBA* 2010, 646.

[476] Belgium: H. GEENS, 'De grondslagen van de culpa in contrahendo', 40 *Jura Falc.* 2003-2004, afl.2, 433; WEINBERGER, *Gestion de portefeuille*, para. 197. France: BRUN, *Responsabilité*, 124; PH. LE TOURNEAU, *Droit de la responsabilité et des contrats*, Paris, Dalloz, 2012, para. 966. See with regard to the UK: CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 12-21, clarifying that damages cannot be obtained as a remedy for mistake as such, yet to the extent the mistake was caused by another party’s misrepresentation, damages for misrepresentation may be claimed (provided that the requirements are met). The Netherlands: JANSEN, 'Aansprakelijkheid voor onjuiste informatieverstrekking', 55.

[477] When contracts are rescinded or declared void, the consequences of rescission or void contracts may be considered to apply with retroactive effect (*ex tunc*) or the consequences may only take effect for the present (‘*ex nunc’)*. See in this regard: ERNST, 'Mistake', 1176; see also (comparative): J. BAECK, *Restitutie na vernietiging of ontbinding van overeenkomsten*, Antwerpen, Intersentia, 2012; with regard to Germany and restition in case of void asset management contracts, see for instance: CASPER and ALTGEN, 'Germany', para. 4.145.

[478] The more restrictive stance has more particularly been observed in Belgium, the Netherlands, France and Germany. See in this regard also: P. HUBER, 'Termination of contract', J. BASEDOW, K.J. HOPT and R. ZIMMERMANN, *The Max Planck encyclopedia of European private law*, Vol. II, Oxford, Oxford University Press, 2012, 1653; VANDENDRIESSCHE, 'Causaliteit en bewijslast’, 175. With regard to France: SPITZ, *La réparation*, 158, para. 246 in particular.

[479] Kh. Brussel, 9 February 2011, *J.T.,* 2011, n° 6438, 403 with annotation.

126. Although the annulment of financial transactions or investment contracts may be possible under the circumstances and in the situations described in the preceding paragraphs, it should be borne in mind that the consequences of annulment may be far-reaching and may even unhinge the market in certain circumstances, for instance when it concerns an annulment of thousands of subscriptions in a public securities offering.[480] The possibility to dispute the validity of transactions after the facts has been considered harmful to the adequate and orderly functioning of the market and the need to ensure continuity and stability.[481] In the Netherlands, these concerns were a direct reason for the legislator to deviate from the general rule laid down in art. 3:40 DCC and adopt a specific provision (art. 1:23 Wft) barring investors from claiming annulment on the sole ground that a financial transaction or investment contract can be related to the violation of a mandatory rule.[482] In cases where legislators have not expressly intervened and provided rules in this regard, courts have occasionally also been found to display reluctance to annul contracts relating to financial instruments, especially since similar results in terms of compensation can be achieved by means of compensatory damages, without the need to annul or rescind transactions or contracts concluded in the past.[483]

127. Besides the difficulties that may arise when reversing financial transactions, the restraint and reluctance towards nullity sanctions probably also relates to the fact that restitution following annulment or rescission allows investors to obtain compensation for losses suffered due to market factors, whereas this is not *per se* the case in the context of compensatory damages.[484] This observation must be put into perspective however. Even though the possibility to adjust damages in the light of the circumstances of the case may explain why some courts have favored compensatory damages instead of annulment and rescission, finding that market circumstances and economic factors could raise complex questions that render the assessment of damages notably difficult, some (Italian)

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[480] RAVELINGIEN, Privaatrechtelijke handhaving, 1901

[481] This was for instance argued in the position paper handed down by the Tilburg Institute for Law and Economics (TILEC) commissioned by the Ministry of Finance, Department Financial Markets (Directie Financiële Markten Ministerie van Financiën) to investigate the potential impact of the possibility to annul transactions effectuated in violation of mandatory rules. The paper can be consulted: R.H.J. VAN BIJNEN and W.H. VAN BOOM, Nietigheid bij overtreding van financiële toezichtwetgeving, 23 June 2005, Position paper TILEC, available at http://www.tilburguniversity.edu 35 p. See in this context also: VAN BOOM, 'Financiële toezichtwetgeving en nietige overeenkomsten', 5-36. These reasons were adopted by the legislator in the enactment of art. 1:23 Wet van 28 september 2006, houdende regels met betrekking tot de financiële markten en het toezicht daarop (‘Act on Financial Supervision’, or ‘Wft’); see: *Kamerstukken II*, 2005-2006, 29 708, nr. 19, p. 392. See also the references in the previous ftn.

[482] See the discussion above with regard to art. 1:23 Wft.

[483] See for a similar conclusion: HUBER, 'Termination of contract', 1653; with regard to Belgian case law, see for instance: VANDENDRIESSCHE, 'Causaliteit en bewijslast', 184. See also: Kh. Brussel, 9 February 2011, *JT* 2011, n° 6438, 403 with annotation. With regard to France: SPITZ, *La réparation*, 158, para. 246 in particular.

[484] Commentators in various jurisdictions have suggested that the fact that restitution allows investors to obtain compensation for losses suffered due to market factors has caused courts to prefer awarding compensatory damages instead. Awarding damages allows the court to determine the recoverable loss that is has been caused by the wrongdoer’s fault, without shifting losses due to external market factors to the wrongdoer. As it is generally accepted that investment risk inherent to investment activities should be borne by the investor, courts seem more comfortable with claims for damages. See in this regard: (Germany) T. BAUMS, 'Haftung wegen Falschinformation des Sekundärmarktes', *ZHR*, 2003, n° 167, 143 with references to the case law in this regard cited in ftn. 15: G. WAGNER, 'Schadensberechnung im Kapitalmarktrecht', *ZGR* 2008, heft 4, 513; T. SPROCKHOFF, 'Die Bankenhaftung bei Abschluss und Umsetzung eines Vermögensverwaltungsvertrags in der richterlichen Praxis', *WM* 2005, heft 37, 1745; (France) SPITZ, *La réparation*, 260, para. 240 (“Les préjudices de décision paraissent certes plus faciles à appréhender dans la mesure où ils comprennent l’aléa boursier ce qui évite de déterminer, dans la variation des cours, la partie qui résulte uniquement de la faute boursière. Cet avantage du préjudice de décision […] a conduit les juges à privilégier sa réparation […]".). (The Netherlands) VAN BAALEN, *Zorgplichten*, 265-266 and 441 ff. See also more extensively: (Belgium) VANDENDRIESSCHE, 'Causaliteit en bewijslast', 183-186, with references cited to the case law and: E. VANDENDRIESSCHE, ''Fraud-on-the-market': Een causaliteitstheorie inzake beleggersverliezen', *TPR* 2011, afl. 2, 317, paras. 52-55.

courts seem to have reasoned the other way around and were found more willing to grant restitutionary claims instead of compensatory damages.[485]

3. Other contractual remedies: non-imputable transaction(s), rescission and termination of contract

128. Provided that certain conditions are met, rescission or termination of contract may be invoked, potentially coupled to damages to cover for the loss that is not recovered by rescission or termination of the contract.[486] These remedies generally apply if one of the parties defaulted on the contract[487], although in case contracts have been concluded for an indefinite period of time they may be terminated at any time by either of the parties.[488] Depending on the legal system and conditions set by the national laws, termination of contract frees the contract parties of their obligations under the contract either at the date of termination or with retroactive effect, which may require that restitution is made for the performances that were already carried out by the parties.[489] Alternatively, in case an intermediary acts on behalf of the client-investor and violates the mandate as agreed by the parties, the

[485] PERRONE and VALENTE, 'Investor protection in Italy', 39, concluding that since the measure of damages appears to be a major problem for Italian courts (*sic*), it may have encouraged the widespread use of restitutional remedies as a means to avoid the matter of damages assessment altogether. The authors note that the violation of formal requirements and rescission for violation of precontractual duties has been overemphasized in this regard. See in this context also: (Switzerland) P.C. GUTZWILLER, 'Unsorgfältiger Vermögensverwaltung. Beweislast, Haftungsausschluss und Schadensberechnung', *AJP/PJA*, 2000, Nr. 1, 64, stating that the difficulties encountered in assessing the loss should not impact the decision of the court to grant restitution rather than compensatory damages.

[486] Note that according to the UK common law system, rescission is an equitable remedy while it may also be applied as a remedy under the Misrepresentation Act (see below). See in this regard also: CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 101 ff.; HUDSON, *Securities Law*, 668, para. 24-139 ff.

[487] HUBER, 'Termination of contract', 1653. Art. 9:301 PECL and III.-3:502 DCFR also provide for a termination right upon default.

[488] In various jurisdictions, the modalities and conditions applicable to the termination of investment services contracts is specifically arranged in mandatory legislation, especially when it concerns asset management. Germany: In case the asset manager has discretionary powers to carry out the contract, the client is entitled an unlimited right to terminate the contract. See for instance: CASPER and ALTGEN, 'Germany', 111, para. 4.60. Additionally, the contract itself will generally include provisions on the termination of the contract SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §5, para. 45. Since asset management concerns a contract to be executed on a continuous, prolonged basis, the contract can be terminated without costs when there is sufficient reason to do so, for instance when the asset manager breaches the contract, causing the investor-claimant to lose confidence. P. BALZER, 'Vermögensverwaltung', P. DERLEDER, K.-O. KNOPS and H.G. BAMBERGER, *Handbuch zum deutschen und europaïschen bankrecht*, Berlin, Springer, 2009, 1503, para. 67 ff. On the conditions and regulation to terminate investment management contracts in the UK, see extensively: T. SPANGLER (ed.), *Investment Management*, Oxford, Oxford University Press, 2010, 339 ff. France: the client is entitled to terminate an asset management contract regardless of whether a fixed duration had been contractually agreed on. These rules have been laid down in mandatory rules rendering contrary clauses to the contrary void. See: COURET, GOUTAY and ZABALA, 'France', 62-63, para. 3.18. The Netherlands: with regard to the termination of contractual mandates: art. 7:422 (4) DCC. The client-investor may terminate the (asset management) contract at wish. This is a mandatory rule with regard to private individuals not acting in the course of a business or profession (BUSCH and SILVERENTAND, 'The Netherlands', 215, para. 7.74). Luxembourg: Asset management contracts can be terminated at the client's request; PH. BOURIN, *La gestion de portefeuille*, Louvain-la-Neuve, 2009, 267 (the author also notes that the termination of an asset management contract is often motivated by an investor's discontent).

[489] HUBER, 'Termination of contract', 1653. With regard to Germany: see for instance §§346 BGB ff. In the UK, rescission may be based on s.2(1) Misrepresentation Act, as discussed in more detail below, or as remedy for misrepresentation in equity. See in this regard: CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, para. 4-01. In case the contract is rescinded, void or unwound, parties are generally restored back into the position as they were before the conclusion of the contract. See in detail with regard to the consequences of rescission and annulment of contracts (comparative): BAECK, *Restitutie na vernietiging of ontbinding van overeenkomsten*, . See also: HUBER, 'Termination of contract', 1653; and with regard to the consequences of rescission in the UK: CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, para. 4-05.

transactions effectuated by the intermediary may be considered non-imputable to the client and have to be borne by the intermediary who exceeded the mandate according to the law of agency.[490]

D. Investor redress: precontractual liability

129. As mentioned in the preceding section, to the extent that a contract party would not have entered into the contract absent the wrong (e.g. misleading information), the contact may be annulled (the Netherlands, Belgium and France) or rescinded (Germany and the UK).[491] The underlying rationale for the annulment or rescission of the contract in these cases is the lack of informed consent on account of the claimant, resulting in the invalidity of the contract as this puts the claimant back into the situation he would have been in but for the misrepresentation (or other precontractual breach). Annulment or rescission is not always an appropriate solution to the problem however. Parties might also sue for precontractual breaches in those cases where a contract was not (yet) concluded or where parties incurred losses that are not compensated for by an annulment (possibly additional to an annulment of the contract). It is also possible that the parties contend that the contract would have been concluded regardless of the precontractual breach, but against more favorable conditions had they been correctly informed. In the latter case, a precontractual claim for damages will be available to the claimants. Summarized, precontractual liability is imposed on persons and entities conducting themselves in a harmful manner towards a potential contract party with whom they may or may not conclude a contract, yet at the moment the harmful event occurs, no contract has been concluded (yet).[492] Since this thesis deals with investor litigation, which is mostly concerned with misrepresentation and breaches of informational and advisory duties or shortly, liability for misstatements, precontractual liability is discussed from that angle. Precontractual liability issues with regard to the breaking-off of contractual negotiations, confidentiality matters and the like are not taken into account.

[490] France: Art. 1998 FCC, see in this regard also: COURET, GOUTAY and ZABALA, 'France', 76, para. 3.75. UK: L. VAN SETTEN, *'The law of institutional investment management'*, Oxford, OUP, 2009, 83, para. 3.29, p.121, para 3.105 and p. 264. Belgium: KRUITHOF, 'Privaatrechtelijke werking', 322, para. 45-46; WEINBERGER, *Gestion de portefeuille*, 145, para. 204. See also art. 3:204(1) PECL ("Where a person acting as an agent acts without authority or outside the scope of its authority, its acts are not binding upon the principal and the third party."). And: II-6:107 DCFR.

[491] BEALE, HARTKAMP, KÖTZ and TALLON (eds.), *Contract Law*, 333 ff. For a comparative overview with respect to France, Germany and the UK. See particularly: Germany: §119 BGB and §123 BGB; see also VON BAR and DROBNIG, *The interaction of contract law*, para. 344; The Netherlands: J. HIJMA, C.C. VAN DAM, W.A.M. VAN SCHENDEL and W.L. VALK, *Rechtshandeling en overeenkomst*, Deventer, Kluwer, 2007, 177, n° 159; Belgium: art. 1117 BCC. STIJNS, *'De sanctionering van de wilsgebreken'*, 130-168; 141, WEINBERGER, *Gestion de portefeuille*, para. 197. The Netherlands: art. 6:228(1)(a) BW in case of unintentional misrepresentation; art. 3:44(1)(3) BW in case of fraud. See for instance: J. CARTWRIGHT and M. HESSELINK (eds.), *Precontractual Liability in European Private Law*, Cambridge, Cambridge University Press, 2008, 385 ff. France: art. 1109 and 1116 FCC. See also in the literature: SPITZ, *La réparation*, para. 245 ff.; C. CLERC, 'La réparation du préjudice subi par un actionnaire du fait de la diffusion de fausses informations', *RTD Fin.*, 2007, n° 1, 34; See for instance in the case law: CA Paris, 25th Ch., 4 July 2003, (*Baracat*), n° 2001/03919, Jurisdata: 2003-229676; *Bull. Joly Sociétés*, 2003, n° 11, 1156 ff.; CA Paris, 25th Ch., 29 April 1994, (*Vilgrain*), Jurisdata: 1994-021846; Cass., comm., 27 February 1996, (*Vilgrain*), n°94-11.241, Jurisdata: 1996-003972; *JEP* 1996, n° 26, II 22665, with ann. by by J. GHESTIN.

[492] With regard to Germany, see for instance: MARKESINIS, *The German law of obligations*, 195 ff.; BAMBERGER, 'Anlageberatung', 1417, para. 25; ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, 115, para. 14. Belgium: for a general overview, consult: A. DE BOECK, 'De precontractuele aansprakelijkheid Anno 2010', in A. DE BOECK, I. SAMOY and S. STIJNS (eds.), *Themis cahier verbintenissenrecht*, Brugge, Die Keure, 2010,1-24; GEENS, 'De grondslagen van de culpa in contrahendo', 433. See also: K. MARESCEAU, 'De nieuwe gedragsregelen bij het verrichten van beleggingsdiensten', *DCCR* 2007, 297. With regard to the application on financial transactions, see for instance: RAVELINGIEN, Privaatrechtelijke handhaving, 120 ff. The Netherlands: art. 6:228 BW. See also: HARTKAMP, *Verbintenissenrecht. Algemeen overeenkomstenrecht*, 179, para. 218. UK: HUDSON, *Securities Law*, 668 ff.

130. One of the most ambiguous areas in liability law with regard to the nature of the liability and the remedies to redress is the field of precontractual liability.[493] In France, Belgium and the Netherlands for instance, the precontractual liability doctrine has been developed by courts and allows for claims for damages filed based on general non-contractual liability law (art. 1382-1383 of the respective French and Belgian civil codes, art. 6:162 DCC).[494] With regard to the recoverable loss, the general non-contractual liability rules apply and aim to put the wronged party in the position he would have been in had the harmful act not occurred.[495] Other than is the case in France, Belgium and the Netherlands, precontractual liability is considered (quasi-)contractual in nature according to German law.[496] Claims for precontractual liability can particularly be filed under to §§280(1), 311(2) and 241(2) BGB.[497]

131. Other than the aforementioned civil law countries, UK law does not have an overarching doctrine on precontractual liability.[498] Instead, many situations covered by precontractual liability in civil law countries give rise to liability based on other legal grounds in the UK, including the torts of fraudulent and negligent misrepresentation[499], contractual liability, estoppels, trust law and even equity law.[500] With regard to the breach of informational duties though, it is clear that the torts of fraudulent and negligent misrepresentation are the prevailing causes of action in the UK common law system.[501] It should be noted that under section 2(1) of the Misrepresentation Act 1967, claimants also have a

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[493] See for instance: JANSEN, 'The Concept of Non-Contractual Obligations', 21 ff.

[494] Belgium: The Court of Cassation considers precontractual liability to be based on art. 1382 BCC, which is also the basic legal principle covering for non-contractual liability claims. See: Cass., 10 December 1981, *Arr. Cass.* 1981-82, 502; *Pas.* 1982, I, 494; *R.C.J.B.* 1986, 5, with ann. by E. WYMEERSCH. See case law from the lower courts as well: Gent 14 May 1982, *RW* 1984-1985, 1851; Antwerpen, 3 December 2007, *TBBR* 2009, afl. 5, 254, with ann. by S. MARYSSE; Liège, 24 April 2001, *R.R.D.* 2001, afl. 101, 424; *TBBR* 2004, afl. 5, 253, with ann. by A. DE BOECK; *TBH* 2001, 748; *TBH* 2001 (text of the decision), 559; Brussel 22 January 1985, *JT* 1985, 718. See in the literature: R. KRUITHOF, H. BOCKEN, F. DE LY and B. DE TEMMERMAN, 'Overzicht van rechtspraak (1981-1992). Verbintenissen', *TPR* 1994, 430; P. VAN OMMESLAEGHE, 'Examen de jurisprudence (1974 à 1982). Les obligations', *R.C.J.B.* 1986, 146-147, para. 59; GEENS, 'De grondslagen van de culpa in contrahendo', 433. France: SPITZ, *La réparation*, 212 ff.; VINEY, *Introduction à la responsabilité*, 537, n° 193-4, and 560, n° 199-1 and cases and references cited; see also: P. GILIKER, *Pre-contractual Liability in English and French law*, The Hague, Kluwer Law International, 2002, 105; JANSEN, 'The Concept of Non-Contractual Obligations', 21. For a detailed analysis of precontractual damages in France, see also: CARTWRIGHT and HESSELINK (eds.), *Precontractual Liability*, 29-32 and ftns. 32 ff. The Netherlands: JANSEN, 'Aansprakelijkheid voor onjuiste informatieverstrekking', 55. For an example: Rb. Leeuwarden 23 October 2007, LJN BB6528, (*X./Aegon*), r.o. 8.5.

[495] Note that the prevailing opinion in the Netherlands takes this position. See for instance: HARTKAMP, *Verbintenissenrecht. Algemene leer der overeenkomsten*, para. 197, para. 487; VAN BAALEN, *Zorgplichten*, 258-259. See on this subject also: J.M. BARENDRECHT, 'Pure Economic Loss in the Netherlands', E. HONDIUS, *Netherlands reports to the Fifteenth International Congress Of Comparative Law*, Antwerp, Intersentia, 1998, 122; JANSEN, 'Aansprakelijkheid voor onjuiste informatieverstrekking', 55. Yet, other commentators have subscribed another point of view, holding that the damages should restore the aggrieved party into the position as if the wrongful information provided by the defendant was true. In this regard for instance: CARTWRIGHT and HESSELINK (eds.), *Precontractual Liability*, 385, ftn. 95 and the references cited.

[496] See on the legal nature of precontractual liability claims also: JANSEN, 'The Concept of Non-Contractual Obligations', 21 ff.

[497] For an overview of the development of precontractual liability in Germany: VON HEIN, 'Culpa in contrahendo', 430; VAN DAM, *European Tort Law*, 172-173, para. 713; BANAKAS, 'Liability for Incorrect Financial Information', 282; VON BAR, 'Liability for information and opinions', 118; VON BAR and DROBNIG, *The interaction of contract law*, para. 187; J. BASEDOW and W. WURMNEST, *Third-party liability of classification societies: A Comparative Perspective*, Berlin, Springer, 2005, 45 ff.

[498] See GILIKER, *Pre-contractual Liability*, 93; BEALE, HARTKAMP, KÖTZ and TALLON (eds.), *Contract Law*, 333 ff.; VON BAR and DROBNIG, *The interaction of contract law*, paras 353-355.

[499] GILIKER, *Pre-contractual Liability*, 106.

[500] BEALE, HARTKAMP, KÖTZ and TALLON (eds.), *Contract Law*, 333 ff.; VON BAR and DROBNIG, *The interaction of contract law*, paras 353-355.

[501] GILIKER, *Pre-contractual Liability*, 106.

claim for false statements made during the negotiation for a contract and relied on by the claimant in concluding the contract.[502]

132. UK: S.90 FSMA (statutory tort) and the Misrepresentation Act. – According to UK law, liability following violations of the rules on prospectus information and listing particulars is governed by statutory rules that distinguish between contractual claims and non-contractual liability claims. The Misrepresentation Act offers a cause of action for anyone who suffered losses resulting from a fraudulent or negligent misrepresentation which induced the claimant to conclude a contract.[503] In case of fraudulent misrepresentation, the investor has the right to rescind the contract he entered into because of fraudulent information.[504] If the misrepresentation was not made fraudulently[505], the court can also decide to award damages instead of rescission based on s. 2 (2) Misrepresentation Act.[506] The measure of damages corresponds to the damages for common law tort of deceit.[507]

133. Advantages of claims based on s.2 (1) Misrepresentation Act.[508] – Section 2 (1) Misrepresentation Act applies both to misrepresentations due to misstatements and omissions and facilitates (investor) claims to a considerable extent since no proximity or special relationship must be proven as is the case with misrepresentations based on the tort of negligence.[509] Moreover, a considerable part of the burden of proof is reversed since scienter or knowledge on the side of the defendant is presumed and can only be rebutted if the seller of the securities demonstrates that he believed the statements to be true, and could also reasonably believe the statements to be true. Furthermore, rather than applying the measure of damages applied in the tort of negligence, the measure of deceit applies, which is more generous because the limitation of foreseeability does not apply in deceit.[510]

134. Relevance of precontractual liability for investor suits. – Precontractual liability claims are highly relevant to investors seeking redress for losses suffered following alleged breaches in the area of financial services.[511] In those cases where unsuitable advice or inadequate information prior to the

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[502] With regard to the Misrepresentation Act 1967 and the torts of negligence and deceit: see *infra*. para. 133.

[503] S. 2 (1) Misrepresentation Act, available at: http://www.legislation.gov.uk/ukpga/1967/7.

[504] The possibility to rescind the contract is lost in certain circumstance. For example when the claimant confirms the contract after discovering the misrepresentation, omits to react timely to the discovery, or in case the company is in liquidation. *Clough v. London and North Western Railway,* (1871) LR 7 ex. 26; N. BOURNE, *Bourne on Company law*, New York, Routledge, 2011, 69. E. AVGOULEAS, *The Mechanics and Regulation of Market Abuse. A Legal and Economic Analysis*, Oxford, Oxford University Press, 2005, 428-429 and references cited. See also: HUDSON, *The Law of Finance*, 502, para. 20-37.

[505] AVGOULEAS, *Mechanics and Regulation of Market Abuse*, 428-429; BOURNE, *Bourne on Company law*, 68-69; HUDSON, *The Law of Finance*, 410-413. Extensively on the rescission option: HUDSON, *The Law of Finance*, 20-98–20-37.

[506] BOURNE, *Bourne on Company law*, 68-69; G. MCMEEL and J. VIRGO, *Financial advice and financial products: law and liability*, Oxford, Oxford University Press, 2001, para. 9.16.

[507] See for instance: Royscott Trust v. Rogerson (1991) 2 Q.B. 297 CA, stating that damages based on s.2 (1) Misrepresentation Act must be measured according to the same principles as damages awarded for fraudulent misrepresentations. See on this decision also: MCMEEL and VIRGO, *Financial advice*, 242, para. 9.16; and: CARTWRIGHT, *Misrepresentation, mistake and non-disclosure,* 7-31 ff. CARTWRIGHT points out however that in the future, the House of Lords may overrule this arrangement and hold that the measure of damages should be the same as in the tort of negligence, which implies that recoverable loss is limited to foreseeable losses (para. 7-38).

[508] In a similar sense: CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 7-47.

[509] See also: HUDSON, *Securities Law*, para. 24-116 ff.

[510] See *supra*, para. 132.

[511] See in this regard also: WEINBERGER, *Gestion de portefeuille*, 139; VAN BAALEN, *Zorgplichten*, 248, 256 ff. See also the country reports in D. BUSCH and D.A. DE MOTT (eds.), *Liability of asset managers*, Oxford, OUP, 2012, for instance: COURET, GOUTAY and ZABALA, 'France', 74, para. 3.65; CASPER and ALTGEN, 'Germany', 116; para.4.86; RIASSETTO and RICHARD, 'Luxembourg', 184, para. 6.81; VAN SETTEN, 'England and Wales', 339, para. 11.28.

conclusion of the contract has been provided, or when an improper investment strategy has been recommended, claimants may file claim on a precontractual basis. This includes cases in which insufficient information has been provided on the risks involved, or in case the financial service provider did not gather adequate information on the client's experience, investment objectives, investment horizon, knowledge, financial condition, or did not take these elements adequately into account. Note that in Germany and in Belgium, evidential facilitations have been provided (either by courts or by legislation) in terms of causal presumptions that reverse the burden of proof with regard to the causal relation between the violation and the loss claimed. In Germany for instance, courts apply a presumption of causation ('*Vermutung aufklärungsrichtigen Verhaltens'*) in cases of violation of (precontractual or contractual) information obligations, which has facilitated investor claims considerably.[512] In Belgium on the other hand, a presumption of causation applies in case of breaches of the MiFID rules of conduct.[513] As to claims following deficient market disclosures, precontractual liability may be of importance as well, mostly in cases where no (more favorable) alternative legal grounds are available.[514]

135. Conclusion. – Overall, precontractual liability is an important cause of action for investors with regard to breaches of informational duties and duties of care imposed on financial services providers, issuers and other market participants disseminating information to the market. The comparative overview shows that claims for misrepresentations and other breaches of precontractual obligations are possible and available in each of the Member States examined to this end. Whereas civil law countries have developed precontractual liability doctrines – either based on non-contractual liability rules as in the Netherlands, France and Belgium, or on contractual liability as is the case in Germany – the UK has no overarching precontractual liability doctrine, yet allows for similar claims for similar complaints under the torts of fraud and negligence, and to the extent a contractual relation is established, the Misrepresentation Act 1967.

II. Causation, recoverable loss and assessment of damages in the Member States' private laws

A. Recoverable loss

1. Concept of recoverable loss

136. Concept Recoverable loss. – The recoverability of a loss first depends on what constitutes the notion 'recoverable loss'. It is a generally accepted principle in the European legal systems that the recoverable loss is the loss that would not have been suffered absent the event that gave rise to the claim.[515] As already indicated in the previous section, France and Belgium employ fairly open tort

[512] See *infra*: para. 200.

[513] Art. 30ter Law on Financial Supervision. This presumption of causation is discussed in the next chapter (see *infra*: Part II, Chapter I, para. 207).

[514] Investor claims following deficient prospectus information are for instance considered precontractual in nature in Belgium. See in this regard: TISON and RAVELINGIEN, 'Roma Locuta', 256-257; see also: RAVELINGIEN, Privaatrechtelijke handhaving, 116-120.

[515] Germany: S. MARTENS and R. ZIMMERMAN in WINIGER, KOZIOL and ZIMMERMAN (eds.), *Digest of European Tort law*, 17-18; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, 418, para. 41; KOZIOL, *Basic questions of tort law*, 293. Switzerland: R.H. WEBER, 'Anlägeschaden', S. EMMENEGGER, *Anlagerecht*, Bern, Schulthess, 2007, 137; C. ROSAT, *Der Anlageschaden. Schadensberechnung beim Vermögensverwaltungsvertrag*, Bern, Stämpfli, 2009, 29. Belgium: BOCKEN and BOONE, *Schadevergoedingsrecht*, 53, para. 70; RONSE, *Schade en schadeloosstelling*, nrs. 5.2, 22; M. VAN QUICKENBORNE,

systems as every breach to a legitimate interest in considered principally compensable.[516] In Germany and the UK on the other hand, recoverable loss only exists to the extent protected rights have been violated or respectively, torts have been provided to recover a certain recognized protected interest that gives rise to common law damages.[517] Furthermore, in the Netherlands, limitations to recoverable loss may apply as a result of the relativity requirement.[518]

Notwithstanding the differences between the Member States' liability laws, however, it is a generally accepted principle that both in contract and in tort, damages generally aim to indemnify the aggrieved party for injury inflicted by the wrongful behavior by the defendant and hence restore the victim in the situation as it would have been in absence of the breach that gave rise to the claim.[519] Whereas some Member States only codified the main principles setting out a right to recovery[520], the German legislator enacted more specific legislative provisions on the concept of recoverable loss.[521] For instance in Germany, the right to recovery – applicable to both contractual and non-contractual liability claims – is prescribed in §249 BGB, according to which a wrongdoer must restore the position of the victim as it would have been without the occurrence of the fault that gave rise to the claim. According to §249 BGB, compensation should principally consists of restitution in kind ('*Naturalrestitution'*), damages are only employed in second instance, when restitution in kind in inappropriate or impossible.[522] The preference for restitution in kind is based on the premise that this kind of recovery is best suited to provide complete and full indemnification to victims (*restitution in integrum*).[523] Another provision of importance in German law in this regard is §253 BGB, according to which states that monetary compensation cannot be awarded for immaterial damage ('*Immaterieller Schaden'* or '*Nichtvermögensschaden'*) is suffered, unless it is expressly provided for by statute.[524] Applied in the context of investor losses, the concept '*Nichtvermögensschaden'* specifically applies to losses that result from the distortion of an investor's free consent to a transaction or contract and are traditionally remedied by means of rescission and restitution ('*Rückabwicklung als*

Oorzakelijk verband tussen onrechtmatige daad en schade, Mechelen, Kluwers, 2007, 57; The Netherlands: HR, 3 February 2012, LJN BU4914, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), *JOR*, 2012/116, with ann. by S.B. VAN BAALEN; *Ondernemingsrecht* 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; also available at www.rechtspraak.nl; Hof Amsterdam 4 January 2004, LJN BA3384, *RF* 2007, 44; Hof Leeuwarden 29 November 2011, LJN BU6235, *RF* 2012, 25; see also: VAN BAALEN, *Zorgplichten*, 405; M. VAN LUYN and E. DU PERRON, *Effecten van de zorgplicht*, Deventer, Kluwer, 2004, 271; S. LINDEBERGH and H.T. VOS, 'the Netherlands', in WINIGER, KOZIOL and ZIMMERMAN (eds.), *Digest of European Tort law*, 29. UK: MCMEEL and VIRGO, *Financial advice*, 401, para. 16.01. France: S. BONFILS, *Le droit des obligations dans l'intermédiation financière*, Paris, L.G.D.J., 2005, 212, para. 423.

516 Belgium: Cass., 16 January 1939, *Pas.* 1939, I, 25; RONSE, *Schade en schadeloosstelling*, n° 13; BOCKEN and BOONE, *Schadevergoedingsrecht*, 58, para. 77; B. DUBUISSON, I.C. DURANT and N. SCHMITZ, 'Belgium' in WINIGER, KOZIOL and ZIMMERMAN (eds.), *Digest of European Tort law*, 26-27; DE CALLATAŸ and ESTIENNE, *La responsabilité civile*, 21. France: J.S. BORGHETTI, 'France' in WINIGER, KOZIOL and ZIMMERMAN (eds.), *Digest of European Tort law*, 24-25; BRUN and QUÉZEL-AMBRUNAZ, 'French Tort Law', 78.

517 Discussing the differences in the notion 'damage' in French and German law: BRUN and QUÉZEL-AMBRUNAZ, 'French Tort Law', 78; S. MARTENS and R. ZIMMERMAN, in WINIGER, KOZIOL and ZIMMERMAN (eds.), *Digest of European Tort law*, 17-18. UK: GORDLEY, *Foundations of private law*, 166 ff. See also the discussion on the scope of non-contractual liability *supra* (para. 112).

518 *Supra* para. 114.

519 See the references in ftn. 515.

520 See for instance Belgian and French (non-contractual) liability law: art. 1382 BCC, respectively FCC; and Italy: art. 2056-2059 ICC, which lay down the general principle according to which aggrieved parties are entitled to recovery if their loss has been caused by the wrongful behavior of a third party. In the Netherlands art. 6:95, art. 6:96 DCC clarify that recoverable loss can consist of material and immaterial loss, and that both suffered loss and foregone profits are recoverable.

521 Germany: §§249-252 BGB. The Netherlands: artt. 6:95; 6:96 DCC.

522 PALANDT (ed.), *Bürgerliches Gesetzbuch*, §249 BGB, para. 2; KOZIOL, *Basic questions of tort law*, 297.

523 KOZIOL, *Basic questions of tort law*, 297.

524 PALANDT (ed.), *Bürgerliches Gesetzbuch*, §253 BGB.

Naturalrestitution').[525] This means that the securities are generally restituted in return for the initial purchase price paid to acquire them by investors (‘*Zug um Zug Rückabwicklung'*). The concept ‘*Nichtvermögensschaden'* contrasts with the concept ‘*Vermögensschaden'*, which includes losses that have not been caused by a distortion of the investor's free will, but instead relate to the price he paid or received for the securities. Losses incurred because of an incorrect price are compensated for by means of monetary compensation. Even though the right to full indemnification is commonly accepted in European legal systems[526], several other jurisdictions generally prefer compensation in damages rather than in kind.[527]

137. Risk v. loss. Another common principle requires that in order to be legally recoverable, the loss should be actually suffered and certain, as opposed to hypothetical and contingent.[528] The mere possibility to incur losses in the future because of violations by wrongdoers does generally not suffice to obtain compensatory damages.[529] At this point in time, the investor can simply sell off the unwanted securities and recover the costs incurred because of corrective transactions.[530] Put differently, as long as the claimant's patrimony has not been negatively affected (compared to the alternative scenario in which no wrongdoing took place), no legally relevant (pecuniary) loss has been suffered, with the possible exception of expenses made to rectify the situation.[531]

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[525] The distortion of one's free will or consent to a contract or transaction is considered an (immaterial) ‘*Rechtsgut'* in German law. See in this regard: PALANDT (ed.), *Bürgerliches Gesetzbuch*, Vorb §249, para. 7; specifically with regard to investor loss: C. ESCHER-WEINGART and A. LÄGERER, 'Schadensersatzanspruch, Schadensart und Schadensberechnung gem. der §§ 37b, 37c, WpHG', *WM* 2004, heft 38, 1848; U. EHRICHE, 'Deutschland', K.J. HOPT and H.C. VOIGT, *Prospekt- und Kapitalmarktinformationshaftung*, Tübingen, Mohr Siebeck, 2005, 294-295.

[526] Comparative: WURMNEST, 'Damages', 445. See with regard to France (‘*réparation intégrale'*): VINEY and JOURDAIN, *Traité de droit civil*, 452, para. 172; Belgium: RONSE, *Schade en schadeloosstelling*, 213, para. 282; DE CALLATAŸ and ESTIENNE, *La responsabilité civile*, 57. The Netherlands: SPIER, *Verbintenissen uit de wet en schadevergoeding*, 169, para 196; I.K. TOXOPEUS-DE VRIES, 'Het begroten van beleggingsschade', D. BUSCH, C.M.J. KLAASSEN and T.M.C. ARONS, *Aansprakelijkheid in de financiële sector*, Deventer, Kluwer, 2013, 236-237. Germany: §249 BGB is based on the principle of complete reparation (‘*Totalreparation'*); S. MARTENS and R. ZIMMERMAN in WINIGER, KOZIOL and ZIMMERMAN (eds.), *Digest of European Tort law*, 17-18; the principle of full compensation is also stated in art. 9:502 PECL; art. 10:101 PETL; Book VI-6:101(1) DCFR.

[527] The Netherlands: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, nr. 21; comparative: WURMNEST, 'Damages', 445.

[528] Belgium: Cass. 29 October 1981, *Arr. Cass.* 1981-82, 315; Cass. 31 May 1931, *Bull. ass.* 1943, 901, stating that in case of doubt regarding the existence of actual damages caused by the defendant, courts are not allowed to award any damages. see also: D. SIMOENS, *Schade en Schadeloosstelling*, Gent, Story Scientia, 1999, 51 ff.; WEINBERGER, *Gestion de portefeuille*, para. 223; ROGER and SALMON, 'Réflexions relatives à la responsabilité contractuelle', 400. The Netherlands: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 16. UK: MCGREGOR, *McGregor on damages*, 325. In the UK however a claimant may nevertheless get some compensation by means of nominal damages insofar he succeeded in establishing an infringement of a right. Nominal damages though are rather symbolic and tend to be estimated at £5 to £10. Extensively on nominal damages: MCGREGOR, *McGregor on damages*, 413 ff. France: (‘*dommage éventuel'*) CA Paris, 15th Ch., 10 June 2005, Jurisdata 2005-279464, (S.A. Aurel Leven Securities/De Botton); BRUN, *Responsabilité*, 112, para. 220. For an overview see also: H.G. TREITEL, 'Remedies for breach of contract (courses of action open to a party aggrieved)', A. T. VON MEHREN, *International Encyclopedia of comparative law, Volume VII, Contracts in General*, Tübingen, Mohr Siebeck, 2008, 83, para. 107.

[529] Extensively in this regard: WINIGER, KOZIOL and ZIMMERMAN (eds.), *Digest of European Tort law*, Chapter 25, ‘Mere Exposure to a danger', 1035 and the country reports discussing the recoverability of mere exposure to danger.

[530] For instance, in case the investor sells the unsuitable and unwanted instruments and replaces them by more suitable investments, he is generally entitled to compensation for the (reasonable) costs made to correct the faulty situation (*infra*, para. 141). Additionally, if the claimant suffers non-pecuniary harm, such as anxiety or stress, because of the excessive risks with which his patrimony has been burdened, he may be entitled to claim damages for emotional or moral harm, although most jurisdictions adopt a rather restrained position on the compensation of moral harm in the context of investment loss (*infra*, para. 142).

[531] Several problems would arise when considering the mere exposure to excessive risk as a recoverable loss in the context of investor litigation. For instance, assuming that mere exposure of risk could be considered a legally relevant and recoverable loss, this would imply that even if the securities were sold before the risk materializes and no financial loss as a result of a

138. Assessment of damages. – Compensation is meant to remedy the injury inflicted and restore the victim into the position as if the violation did not occur, yet without over- or under-compensating the victim. Hence, compensation should remedy the (negative) difference between the hypothetical situation in which no breaches occurred and the actual situation in which the wrongful act occurred.[532] Any loss that would invariably have been suffered in the hypothetical scenario, in which no breach occurred, is not recoverable as a result. For example, in case an asset manager failed to respect the contractual obligation to duly diversify the portfolio, the alternative hypothetical scenario is the scenario in which the portfolio has been sufficiently diversified. Similarly, in case an issuer omitted material facts or withheld new information from the market contrary to the obligation to disclose new information promptly, the alternative situation to take into account is the situation in which all relevant information was completely and timely disclosed. This approach to recoverable loss, being the actual situation contrasted to the hypothetical counterfactual scenario, is generally referred to as the 'difference theory' ('*Differenzhypothese'*, '*vermogensvergelijking'*).[533] As legislative provisions are generally limited to rather abstract and general indications on what constitutes a recoverable loss, it is incumbent on courts to interpret and apply these principles in the light of the circumstances of individual cases. The division into categories of loss as set out below aims to offer a better understanding of what loss may recoverable in the context of investor suits.

2. Components of investor compensation: heads of damages/types of loss

a. Recoverable loss: suffered harm and foregone profits

139. Even though the concept of recoverable loss may seem straightforward, the determination of the recoverable loss and calculation of the damages is often complex in the context of investor suits. The difficulties often relate to the determination of the counterfactual scenario, being the hypothetical scenario in which no breach would have occurred. For instance, with regard to failures to provide

depreciation in investment value is suffered (compared to the alternative scenario in which no wrongdoing occurred), the investor would still be able to demand compensation for the excessive risks. Second, considering the mere exposure of excessive risk recoverable would complicate the situation even more in case the investor did not suffer any loss, but instead obtained a return he would never have obtained with a more suitable, but more conservative investment. For these reasons, it is clear that recoverable loss is conditional upon the materialization of the risk, i.e. the unwanted or unsuitable investment must have recorded a loss that would not have occurred absent the wrong. The moment on which the recoverable loss comes into existence is discussed in detail in the next chapters. See particularly with regard to loss incurred as a result of defective investment services, *infra*: Part II, Chapter II, para. 240; and with regard to loss incurred as a result of deficient market disclosures: Part III, Chapter I, para. 368.

[532] The Netherlands: HR 3 February 2012, LJN BU4914, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), *JOR,* 2012/116, with ann. by S.B. VAN BAALEN; *Ondernemingsrecht*, 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; Hof Amsterdam 4 January 2004, LJN BA3384, *RF* 2007, 44; Hof Leeuwarden 29 November 2011, LJN BU6235, *RF* 2012, 25. See also: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, vol. 6 II, para. 18; VAN BAALEN, *Zorgplichten*, 405; VAN LUYN and DU PERRON, *'Zorgplicht'*, 271; DE JONG, *Schade door misleiding*, 41; TOXOPEUS-DE VRIES, 'Het begroten van beleggingsschade', 236-237.Germany: SCHÄFER, SETHE AND LANG (eds.), *Vermögensverwaltung*, 418, para. 41; KOZIOL, *Basic questions of tort law*, 123; PALANDT (ed.), *Bürgerliches Gesetzbuch*, Vorb v §249, para. 8; HELLGARDT, *Kapitalmarktdeliktsrecht*, 493; C. BENICKE, *Wertpapiervermögensverwaltung*, Tübingen, Mohr Siebeck, 2006, 830-831. Switzerland: WEBER, 'Anlägeschaden', 137; ROSAT, *Der Anlageschaden*, 29; B. CHAPPUIS, *Le moment du dommage*, Zurich, Schulthess, 2007, 29; T. GROSS, 'Fehlerhafte Vermögensverwaltung – Klage des Anlegers auf Schadenersatz', *AJP* 2006, 165. UK: MCMEEL and VIRGO, *Financial advice*, 401, para. 16.01, see also the reference cited in ftn. 1. Belgium: BOCKEN and BOONE, *Schadevergoedingsrecht*, 74-75; L. CORNELIS, 'Ongeschikt voor overgevoelige juristen: over de intieme verhouding tussen schade en causaal verband', B. TILLEMAN and I. CLAEYS, *Buitencontractuele aansprakelijkheid*, Brugge, Die Keure, 2004, 249; RONSE, *Schade en schadeloosstelling*, 8, para. 5.2.; A. VAN OEVELEN, 'Contractuele en buitencontractuele rechtsbescherming van de particuliere belegger in financiële instrumenten', *Bank. Fin. R.*, 2003, 127; WEINBERGER, *Gestion de portefeuille*, para. 223-225. Austria: B. KÖCK, 'Liability for Unsuitable Advice on Investment Funds (Austria)', *JIBLR* 2011, iss. 9, 461.

[533] See the references cited in the previous footnote.

adequate, tailored and suitable advice or information to the investor-client, it may be unclear what the course of action of the investor would have been in absence of the violation. It may well be that the investor would have decided to invest in another (better suited) investment, or maybe appropriate warnings on the risks inherent to investments would have caused the client to abstain from investing at all. In general, three (or in case of issuer liability, four) hypothetical scenarios are possible, the first being that in absence of the wrong, no investment would have been made. This might be the case for instance when after being duly warned on the risks inherent to investments, the investor refuses to go along with any of the suggested investments, or decides to keep his money on a savings account. In this case, the recoverable loss amounts to the difference between the residual value of the financial instruments or portfolio on the one hand, and the initial investment value, to which interest may be added (see further below) on the other hand.

Secondly, it may be that in absence of the wrong, another investment or investment strategy would have been chosen by the investor.[534] In many instances, investors seeking investment advice or an asset manager to invest their funds on their behalf would also have invested in case no breach occurred, although different investments or strategies may have been chosen, adjusted to their preferences, objectives and willingness to take risk.[535] For example, it is not illusionary that an inexperienced investor with limited understanding of financial markets and instruments would have refrained from trading in derivatives had he been duly warned on the risks such investments carry with them, but instead would have chosen a more conservative investment. In these cases, the hypothetical scenario to take into account is the scenario in which such alternative investment is made. Evidently, in this scenario, the initial investment cannot be employed as the relevant benchmark to calculate the loss. Loss calculation based on the initial investment would imply that the investor would have chosen an entirely risk-free investment, or would not have invested at all absent the wrong. In these cases, the first step in damages assessment consists of the determination of the alternative investment the investor would have chosen, which may be very difficult to do. Notwithstanding potential uncertainty on the alternative, hypothetical scenario with which the actual situation could be contrasted, as soon as it has been determined that the aggrieved party would have been in a better situation absent the wrong, the existence of a recoverable loss is established. The second step then consists of a comparison between the outcome of the hypothetical investment and the actual investment, the negative difference being the recoverable loss. Or put differently, to the extent losses would have been suffered in the alternative scenario too, for instance because of a general market downturn, these losses are not

[534] As will be clarified in the next chapter, the prevailing opinion in Germany considers this scenario not applicable in the context of investment advice (other than in the context of asset management). It is generally accepted that absent the wrong information or advice, the investor would not have concluded the contract. See in this regard: ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §4, para. 123; BAMBERGER, 'Anlageberatung', 188; E. REINELT, 'Haftung aus Prospekt und Anlageberatung bei Kapitalanlagefonds', *NJW* 2009, heft 1, 8. Note however that the later observes that following a decision handed down by the BGH, this may be subject to change or at least be discussed (BGH, 3 June 2008, *NJW* 2008, heft 35, 2572).

[535] (The Netherlands) HR 3 February 2012, LJN BU4914, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), *JOR*, 2012/116, with ann. by S.B. VAN BAALEN; *Ondernemingsrecht* 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; also available at www.rechtspraak.nl. *Comp.* with the holding in *South Australia Asset Management Corp. V. York Montague Ltd* (1997) A.C. 191 (handed down by the UK House of Lords), at 218: "But in principle there is no reason why the valuer should not be entitled to prove that the lender ha s suffered no loss because he would have used his money in some altogether different but equally disastrous venture. Likewise the lender is entitled to prove that, even though he would not have lent to that borrower on that security, he would have done something more advantageous than keep his money on deposit". See also: (Austria) OGH, 28 January 2011, 6 Ob 231/10d, available at: http://www.ris.bka.gv.at. See on this decision also: KÖCK, 'Liability for unsuitable Advice', 464. Similar: (Germany) BENICKE, *Wertpapiervermögensverwaltung*, 832; See for a Swiss point of view: ROSAT, *Der Anlageschaden*, 147, 155. ROSAT correctly points out that the hypothesis that the investor would not have invested at all – and is thus entitled to a compensation based on the initial investment – is rather exceptional.

recoverable.[536] Conversely, to the extent a positive return would have been achieved in the scenario of an alternative investment decision, the recoverable loss may exceed the loss of investment value since foregone profits are recoverable in most legal systems.[537] The techniques used to assess the loss in this type of scenarios are elaborated in the following chapters.

Thirdly, it may well be that the investor would not have decided differently in absence of the wrong, which implies that the loss would invariably have been suffered.[538] In the context of deficient market disclosures, there is also a fourth possibility, being that in the hypothetical case that new information would have been disclosed timely and completely, the investor would have traded against a better price, i.e. a higher price in case of selling and a lower price in case of purchasing the securities to which the deficient disclosure relates. This scenario is discussed in detail in the final chapter of the thesis.

b. Interest

140. When courts award damages to compensate for the loss suffered by the claimant, interest on the amount of damages is added to compensate for the deprivation of the money that was owed to him for the period since the loss was suffered until the damages are effectively paid.[539] A distinction may be made between different types of interest, such as compensatory interest (‘*compensatoire interest’*, ‘*intérêts compensatoires’*) and interest on overdue payments (‘*moratoire interest’*, ‘*intérêts moratoires’*).[540] Whereas compensatory interest is awarded for the period since the loss emerged until the day of the judgment, interest on overdue payments is awarded for the period from the judgment until the actual payment of the debt. Whereas compensatory interest form part of the damages, and must be taken into account to calculate the interest on overdue payments, the latter are added to the due damages. The interest rate and the like are generally determined by the courts.

c. Recoverable costs

141. In general, investors can also recover the costs that would not have been made absent the wrong.[541] This includes costs that relate to investments that would not have been made, costs of

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[536] (Germany) BENICKE, *Wertpapiervermögensverwaltung*, 832 (in the context of asset management); BALZER, 'Vermögensverwaltung', §51, 1495-1496, para. 51. (UK) MCMEEL and VIRGO, *Financial advice*, 405, para. 16.13; VAN SETTEN, *'The law of institutional investment management'*, 106, para. 3.73. (France) BOURIN, *La gestion de portefeuille*, 218-219.

[537] See the references cited in the previous ftn. With regard to the recoverability of foregone profits (‘*lucrum cessans’*) for a comparative overview: WURMNEST, 'Damages', 446. See particularly with regard to Germany: §252 BGB; PALANDT (ed.), *Bürgerliches Gesetzbuch*, §252; Belgium: art. 1149 BCC on contractual damages, which are to include suffered losses as well as loss of profits (‘*damnum emergens’, ‘lucrum cessans’*). See also: RONSE, *Schade en schadeloosstelling*, para. 29; BOCKEN and BOONE, *Schadevergoedingsrecht*, para. 91. France: art. 1149 FCC. LE TOURNEAU, *Droit de la responsabilité et des contrats*, para. 1507. The Netherlands: art. 6:96 DCC; HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 14. UK: CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 224-226, para. 5-39; VAN SETTEN, *'The law of institutional investment management'*, 3.106.

[538] This scenario concerns the lack of causation between the violation and the investment decision, but for the sake of completeness this scenario is mentioned here too. The various scenarios are examined in detail in the following chapters.

[539] UK: BURROWS, *Remedies*, 347 ff.; The Netherlands: art. 6:119 DCC, art. 6:83 DCC. See for instance: Rb Amsterdam, 25 April 2012, LJN BW7099, (X./ABN Amro Bank NV), available at www.rechtspraakzoeken.nl., r.o. 4.7; HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, vol. 6.II, para. 44. Belgium: DE CALLATAŸ and ESTIENNE, *La responsabilité civile*, 551; RONSE, *Schade en schadeloosstelling*, 238, nr. 328 ff.

[540] Idem.

[541] (Belgium) WEINBERGER, *Gestion de portefeuille*, 163-164; RAVELINGIEN, Privaatrechtelijke handhaving, paras. 644 and 646; (Germany) OLG karlsruhe 16 march 2000, ZIP 2000, heft 46, 2060. See also: SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 51; S.J. GEIBEL, *Der Kapitalanlegerschaden*, Tübingen, Mohr Siebeck, 2002, 294; CASPER

corrective trades in an investor's portfolio to rectify mistakes by the financial service provider or excessive costs, for instance in case of churning and costs suffered in case the portfolio is transferred to another financial services provider upon termination of an investment services contract for default. Commissions paid to financial services providers cannot be recovered in many legal systems as services have been delivered in return for the amount paid that cannot be restituted.[542]

d. Damages for pain and suffering: moral damages

142. Investor suits are automatically associated with economic, material losses due to market evolutions. Besides economic losses however, claimants also occasionally demand damages to compensate for the moral harm suffered as a result of disappointing investments. Moral harm generally includes pain and suffering, grief, anxiety, stress, inconvenience, mental distress and the like. Examples from the case law however show that compensatory damages for moral harm are only exceptionally awarded by courts. In various Member States, no examples have yet been reported to our knowledge.[543] A restrictive approach is for instance observed in the UK case law. Assessing a claim for damages for stress, anxiety, inconvenience and the loss of amenity caused by financial harm suffered as a result of negligent financial advice, the court held that damages for those kind of suffering can only be awarded to the extent "a major or important object of the contract […] was to give pleasure, relaxation and peace of mind."[544] The court continued to explain that such damages are exceptional, though not impossible, for instance in unusual circumstances and in case the advice would recommend using the funds that were already available to provide for an amenity of which peace of mind was an essential element.[545]

143. In France however, moral damages have been awarded in a limited number of court decisions. These decisions involved cases in which the defendants were found to have either mislead or acted negligently vis-à-vis aged and rather unsophisticated and mostly elder investor-claimants, causing the courts to award moral damages to compensate for the distress and hassle they had suffered at their respectable age.[546] In other instances, moral damages have been awarded as a symbolic gesture, as in

and ALTGEN, 'Germany', para. 4.123; ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §4, para. 123. (The Netherlands) art. 6:96 BW. See also: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 28; VAN LUYN and DU PERRON, *'Zorgplicht'*, 274; DE JONG, *Schade door misleiding*, 38; (Switzerland) L. THÉVENOZ and C. BRETTON-CHEVALLIER, 'Switzerland', D. BUSCH and D.A. DE MOTT, *Liability of Asset Managers*, Oxford, OUP, 2012, para. 10.75; ROSAT, *Der Anlageschaden*, 124. (UK) VAN SETTEN, *'The law of institutional investment management'*, para. 3.105.

542 WEINBERGER, *Gestion de portefeuille*, 163-164; VAN LUYN and DU PERRON, *'Zorgplicht'*, 274; GEIBEL, *Der Kapitalanlegerschaden*, 309, pointing out that remunerations for services that have been delivered are only exceptionally recoverable. For an example of such exception: OLG Hamm, 28 December 1995, *WM* 1996, 672.

543 The Netherlands: VAN LUYN and DU PERRON, *'Zorgplicht'*, 276 (noting that in the context of investor losses, damages for moral or immaterial losses are rare and not easily obtained). See for an illustration: Klachtencommissie DSI, 27 August 2002, KCD-151, *JOR* 2003/89; similar: BUSCH and SILVERENTAND, 'The Netherlands', 237, para. 7.155; TOXOPEUS-DE VRIES, 'Het begroten van beleggingsschade', 233-234; DE JONG, *Schade door misleiding*, 39 and references cited in ftn. 119. Luxembourg: RIASSETTO and RICHARD, 'Luxembourg', 190, para. 6.109; BOURIN, *La gestion de portefeuille*, 216. Belgium: see for instance DE CALLATAŸ and ESTIENNE, *La responsabilité civile*, 475, where it is stressed that moral damages for economic losses or damage to objects are generally not readily available.

544 Seymour anor. v. Ockwell & Co., Zurich IFA Ltd, (2005) EWHC 1137. Similar: MCMEEL and VIRGO, *Financial advice*, 438, para. 16.102.

545 Idem.

546 CA Paris, 11 January 2002, *Bull. Joly Bourse* 2002, 206, §44 with ann. by L. RUET (The wrongful and highly speculative manner with which the claimant's portfolio had been managed caused the elder investor-claimant to worry. The court awarded damages for moral harm amounting to €15 245); CA Paris, 6 October 2011, jurisdata: 2011-031037 (an amount of €2000 was awarded because the breaches had caused the elder investor (65 years) financial worries and tension with regard to her financial means during retirement); CAAix en Provence, 7 January 2010, jurisdata: 2010-011184 (the claimant-investor (66 years old) was awarded damages for moral harm amounting to €3000). In another case, a couple was awarded moral

Regina Rubens for instance where the investor-claimants suffering loss as a result of wrongful issuer disclosure were – in addition to the compensation for their economic loss – also awarded one symbolic euro to compensate for the non-material injury (e.g. distress).[547]

144. Although appropriate when the breach and its consequences effectively cause investors discomfort and distress, moral damages may also be used to circumvent the difficulties courts may encounter in calculating the damages. Contrary to material damages, non-material damages are far more difficult to verify in an objective manner and such left to the discretion of the courts. An example of where moral damages may have been awarded because of the difficulty associated with a verifiable assessment of the scope of the loss is the decision handed down in the dispute between the French fashion house Moët Hennessy Louis Vuitton ("LVMH") and Morgan Stanley.[548] Following repeated negative announcements and analyst reports by Morgan Stanley with regard to LVMH, whereas the direct competitor of LVMH, Gucci, was the subject of positive announcements and recommendations. As Gucci was being advised by Morgan Stanley in a takeover battle with LVMH, LVMH filed claim against Morgan Stanley based for defamation and biased advice and information causing LVMH financial and reputational losses. Finding Morgan Stanley liable for the loss caused by the erroneous information and recommendations, the Paris commercial court appointed an expert to assess the financial loss.[549] Additionally, to compensate for the reputational loss, the court awarded €30 million moral damages, which was affirmed in appeal. The €30 million moral damages awarded to compensate for reputational losses conveniently solve the difficult question on how to calculate this kind of loss.[550] Although there might have been considerable reputational loss, this solution does allow courts to determine damages according to an objectively verifiable manner and, therefore, may create room for arbitrary decisions.[551] Given the difficulties courts encounter in assessing compensatory losses in the context of investor suits, as examined and discussed in the next two parts of this thesis, caution may be advisable since moral damages should be employed to compensate for genuine non-material loss, and not to circumvent difficulties in other respects.

B. Requirement of causation in civil liability law: concept and general principles

145. The emergence of loss following a breach does not suffice to trigger liability however. In all European liability systems, causation is a basic requirement, both in the context of contractual and

damages (€2000 each in addition to a total compensation of €77.174 covering the financial loss suffered) to compensate for the loss of savings they had built up during their lives in speculative investments, the poverty they were confronted with as a result and the marital breakdown that ensued. In assessing the moral damages, the court also took the investors' own imprudence and negligence into account. CA Angers, 19 November 2004, jurisdata 2004-266921, (Guyader/Soc. Gen.).

[547] T. Corr. Paris, 11th Ch., 22 January 2007, n° 0106896039, *RTDF*, n° 2, 2007, 123, with ann. by B. GARRIGUES; the decision was confirmed on this point in appeal: CA Paris, 9th Ch., 14 September 2007, *RTDF*, n° 4, 2007, 145. See on this decision and moral damages in the context of investor claims also: SPITZ, *La réparation*, 242-243. For a critical assessment of moral damages granted in the context of mainly economic losses: V. WESTER-OUISSE, 'Le prejudice moral des personnes morales', *JCP-G*, 2003, no. 26, I, 145 and para. 10 in particular.

[548] This claim is to be situated in the context of liability financial analysts can incur for negligence (in case of incorrect information or unwarranted recommendations) or conflicts of interest issues as was the case with LVHM. The example is nonetheless indicative of the role moral damages can play.

[549] Trib. Comm. Paris, 12 January 2004, LVMH v. Morgan Stanley, *Bull. Joly Soc.* 2004, no. 3, 388; CA Paris, 30 June 2006, *Banque et droit,* 2006, n° 108, 34. With regard to these decisions see also: CLERMONTEL, *Le droit de la communication financière*, 430-433, paras. 657-659; M. KRUITHOF, 'LVMH v. Morgan Stanley: de aansprakelijkheid van financiële analisten met belangenconflicten', *Bank. Fin. R.*, 2004, nr. 4, 215.

[550] Extensively: KRUITHOF, 'LVMH v. Morgan Stanley', 225-226. In a similar sense noting that moral damages may be used to get around difficulties associated with the calculation of reputational damages: WESTER-OUISSE, 'Le prejudice moral des personnes morales', 145.

[551] KRUITHOF, 'LVMH v. Morgan Stanley', 225-226.

non-contractual liability.[552] The requirement of causation between breach and loss is frequently described as one of the most difficult requirements related to the imposition of civil liability.[553] The difficulty in establishing causation often results from the degree of uncertainty in determining the exact cause of a certain event due to intervening circumstances, uncertainty regarding the consecution of events, or simply uncertainty whether there is a factual causal relation between multiple events. In the context of investor losses, courts and literature have repeatedly underlined that investor compensation should be limited to the loss caused by the defendant's wrongdoing, yet losses caused by risks that are inherent to investing – such as general market downturns and changing market circumstances – are to be borne by the investor himself.[554] Again, this may sound straightforward and evident at first glance, but taking into account that investor losses are invariably the result of changing market circumstances causing investments to lose value, this principle does not seem to add much clarification. Instead, it seems more helpful to distinguish between losses that would have been suffered in the alternative scenario as well, i.e. loss that is not causally related to the wrongdoing, and losses that would not have been suffered absent the wrong.[555]

146. Overall, a two-pronged causal analysis is made by courts, being on the one hand a factual inquiry asking whether the wrong caused the loss to emerge, and secondly, an inquiry as to whether certain normative criteria are met, such as reasonableness, foreseeability, adequacy etc. Since mere factual causation does not take any normative considerations into account and may cause liability to be very wide and broad, which may be deemed unfair, unreasonable or too far-stretching in some

[552] J. KLEINSCHMIDT, 'Causation', J. BASEDOW, K.J. HOPT and R. ZIMMERMANN, *The Max Planck Encyclopedia of European Private Law*, Vol. I, Oxford, Oxford University Press, 2012, 156.

[553] BRUN, *Responsabilité*, 141, para. 276; Galoo Ltd. v. Bright Grahame Murray e.a., (1994), 1 W.L.R. 1360, at 1369; SPITZ, *La réparation*, 261; R. MCCORMICK, *Legal risk in the financial markets*, Oxford, OUP, 2010, 19.10; P. LOSER, 'Financial crisis – The liability of banking institutions', 4 *JETL* 2013, iss. 2, 153; BAUMS, 'Haftung Falschinformation, 141.

[554] Belgium: Kh. Brussel, 2 March 2011, *TBH* 2012, afl. 4, 378; Kh. Brussel, 17 January 2006, *TBH* 2008, afl. 1, 87; Brussel, 19 February 2008, *TBH* 2012, afl. 2, 148; Brussel, 3 September 2008, *TBH* 2010, afl. 2, 169; Kh. Brussel 11 April 2008, *TBH* 2010, 160; Gent 4 April 2005, *DAOR*, 2005, 354, *TBBR* 2005, 535; Brussel, 2 June 2009, *JLMB* 2010, nr. 20, 927; Rb. Brussel, 24 February 2012, *Bank. Fin. R.*, 2012/II, 128. See also: ROGER and SALMON, 'Réflexions relatives à la responsabilité contractuelle', 400; VAN OEVELEN, 'Contractuele en buitencontractuele rechtsbescherming', 118; KRUITHOF, 'Privaatrechtelijke remedies', para. 32 and ftn. 108; VANDENDRIESSCHE, 'Causaliteit en bewijslast', 204, 206. Germany: V. POTTHOFF, 'Aufklärungs- und beratungspflichten bei Optionsscheingeschäften', *WM* 1993, nr. 29, 1321. (the Netherlands) DE JONG, *Schade door misleiding*, 53, 184, 188, 189. The Netherlands: HR, 3 February 2012, *JOR* 2012/116, with ann. by S.B. VAN BAALEN (Coöperatieve Rabobank Vaart En Vecht U.A./X.); *AA* 752 (2012) with ann. by. BUSCH; *Ondernemingsrecht* 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; see also: Hof Amsterdam, 27 May 1993, *NJ* 1993, 682 (*Coop AG*), r.o. 5.16 ("it can be considered acceptable that losses have been suffered […] *insofar that loss*, as a consequence of the misleading advertisement, *cannot be considered to be part of the ordinary investment risk* and it can be assumed that the investor relied, or partly relied, on the prospectus"(emphasis added)). A.C.W. PIJLS, 'Het causaliteitsvereiste bij prospectusaansprakelijkheid', *Ondernemingsrecht*, 2009, no. 41, 183 France: CA Paris, (15th Ch.), 26 January 2006, jurisdata 2006-294012, (Vidalies/Société Civile Financière Alexis Davivier); CA Paris, 15th Ch., 9 December 2004, Jurisdata 2004-264162, (Garrigue/La Soc. Oddo & Cie). See also the ECJ case law in this regard. For instance: Case C-215/08 *Friz GmbH* [2010] ECR I- 2947, para. 48-49: "As the *Bundesgerichtshof* observed in its decision for reference, that rule is intended to ensure, in accordance with the general principles of civil law, a satisfactory balance and a fair division of the risks among the various interested parties." and: "Specifically, first, such a rule offers the consumer cancelling his membership of a closed-end real property fund established in the form of a partnership the opportunity to recover his holding, while taking on a proportion of the risks inherent to any capital investment of the type at issue in the main proceedings. Secondly, it also enables the other partners or third party creditors, in circumstances such as those of the main proceedings, not to have to bear the financial consequences of the cancellation of that membership, which moreover occurred following the signature of a contract to which they were not party." For the facts of this case, see *supra*, para. 0. *But:* BGH, 13 December 2011, XI ZR 51/10, (IKB), available at: http://juris.bundesgerichtshof.de, para. 58; *ZIP* 2012, 318. See in this regard: M. HABERSACK, P.O MÜLBERT and M. SCHLITT, *Handbuch der Kapitalmarktinformation*, München, C.H. Beck, 2013, §30, para. 129. See also, *infra*, para. 419.

[555] See *supra*, para. 139.

instances, these criteria are employed to implicate normative and policy-oriented considerations in the causal analysis and limit recoverable losses accordingly.[556]

1. Causation in civil liability law: concept and general principles

147. Causation in fact – or factual causation – implies a causal relation based on a mere factual relation and selects the conditions that were necessary to the emergence of the loss by testing whether the harm would also have occurred absent the wrongdoer's wrongful behavior. If the harm would not have emerged – or would have been less – absent the breach, the factual causal relation between the breach and the loss is established. This test is generally referred to as the 'conditio sine qua non test' in the continental EU Member States[557], whereas the common law countries generally use the term 'but for' test.[558] In eliminating the defendant's harmful conduct, a hypothetical alternative scenario is construed that inevitably requires the courts to make hypotheses. The establishment of causation in terms of conditio sine qua non is also referred to in the Principles of European Tort Law ('PETL').[559] In the Draft Common Frame of Reference on the other hand, the causation test has been formulated as a single clause, unifying both the factual and normative causation test.[560]

2. Normative (legal) causation

a. Overview

148. Normative or legal causation represents the relevance the legal system attaches to the causal factors and aims to select among the factual necessary conditions that are considered legally relevant to impose liability.[561] Since the test of causation in fact is merely aimed at identifying those consequences that in effect stem from the wrongful act, no normative appreciation is taken into account with regard to the establishment of factual causal relations at this level. As a result, a factual

[556] KLEINSCHMIDT, 'Causation', 156.

[557] As it is referred to in Belgium, the Netherlands, France, Switzerland etc. The different naming left aside, both the but for-test and the conditio sine qua non-test are identical in aim and application. See also: *Ibid.*156.

[558] The term 'but for'-test is mainly used in common law countries, including the UK and US. See for instance: *Barnett v. Chelsea and Kensington Hospital Management Committee* (1969) 1 Q.B. 428; *Carslogie S.S. Co. v. Royal Norwegian Government* (1952) A.C. 292. See also: P. GILIKER and S. BECKWITH, *Tort*, London, Sweet & Maxwell, 2008 168. See on the inquiry into factual causation also: R. ZIMMERMANN, 'Conditio sine qua non in general', in B. WINIGER, H. KOZIOL, B.A. KOCH and R. ZIMMERMANN (eds.), *Digest of European Tort Law*, Vol. I. Essential cases on natural causation, Wien, New York, Springer, 2007, 99; KLEINSCHMIDT, 'Causation', 157. See specifically with regard to the UK: MCGREGOR, *McGregor on damages*, 105 ff.; CLERK, LINDSELL, DUGDALE and ALEXANDER, *Torts*, 45; Belgium: M. VAN QUICKENBORNE, H. VANDENBERGHE, L. WYNANT and M. DEBAENE, 'Het oorzakelijk verband', *TPR* 2000, nr. 4, 1869; M. VAN QUICKENBORNE, 'Overzicht van rechtspraak. Aansprakelijkheid uit onrechtmatige daad 2000-2007, Deel I. Oorzakelijk verband', *TPR* 2010, 283; H. BOCKEN and I. BOONE, 'Causaliteit in het Belgische recht', *TPR* 2002, 1625; H. BOCKEN, 'Causaal verband in het Belgische recht', R. VAN DER POEL, D. SCHEENJES and T. VAN DER WAL, *Causaliteit: top-down en bottom-up in Nederlands en transnationaal perspectief*, Antwerpen; Apeldoorn, Maklu, 2011, 124; B. DUBUISSON, 'Jurisprudence récente de la Cour de Cassation sur la relation causale', *JT* 2010, 746-747; France: BRUN, *Responsabilité*, 144. The Netherlands: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para 47 ff. Switzerland: H. WEBER, *Der kausalitätsbeweis im Zivilprozess*, Tübingen, Mohr Siebeck, 1997, 88. UK: CLERK, LINDSELL, DUGDALE and ALEXANDER, *Torts*, 48, para. 2-06.

[559] PETL considers the qualification of a wrongful act as a conditio sine qua non established in case "an activity or conduct is a cause of the victim's damage if, in the absence of the activity, the damage would not have occurred", art. 3:101 PETL, EUROPEAN GROUP ON TORT LAW, Principles of European tort law: text and commentary, 2005, Wien, New York 3; also available at: http://www.egtl.org/; KLEINSCHMIDT, 'Causation', 156.

[560] "A person causes legally relevant damage to another if the damage is to be regarded as a consequence of that person's conduct or the source of danger for which that person is responsible." Book VI-4:103 DCFR.

[561] MCGREGOR, *McGregor on damages*, 107 ff.; HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, n° 51 ff.

causal relation between certain causes and consequences may be present, regardless of how atypical, bizarre, unforeseeable or unusual these consequences might be. Since most jurisdictions prefer to put a certain limit to the recoverable loss, a second layer to the causation requirement is usually added, aimed at filtering the imposition of liability to a degree that is deemed appropriate and fair from a normative perspective.[562] The legally relevant conditions with regard to the imposition of liability differ from one Member State to another, though generally include elements of foreseeability, probability, proximity or policy oriented considerations.[563]

b. Criteria

149. Foreseeability, adequacy and reasonableness. – The criterion to determine whether there is legal causation in the context of contractual liability law is relatively similar in the Member States and essentially requires that the loss was reasonably foreseeable. The rationale underlying the foreseeability criterion is to impose a duty of care only in those cases and to the extent that it might prevent the occurrence of foreseen, though unintended, harm.[564] The foreseeability requirement in the context of contractual liability is generally highly similar to the foreseeability standard used in non-contractual liability cases. Under UK contract law for instance, the requirement of causation in law is to be understood as the reasonable foreseeability of losses for the defendant in the light of his knowledge at the time of contracting ("within the reasonable contemplation of the parties").[565] The foreseeability requirement in the context of common law tort is highly similar to the foreseeability standard in contract.[566] Belgian, French, German and Dutch law[567] also apply foreseeability requirements in the context of contract law, yet foreseeability requirements in Belgian and French law

[562] KLEINSCHMIDT, 'Causation', 156; MCGREGOR, *McGregor on damages*, 107 ff.

[563] Idem. For an overview of the relevant criteria, see also: KLEINSCHMIDT, 'Causation', 159.

[564] Possfund Custodian Trustee Ltd v. Diamond (1996) 1. W.L.R. 1351, at 1365.

[565] This is generally referred to as damages which are 'reasonably contemplate', as it was formulated in the landmark case *Hadley v. Baxendale* (1854) 156 ER 145, 9 ExCh 341. The case was decided by stating that two principles should determine the recoverable losses in terms of foreseeability: "Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract**,** as the probable result of the breach of it",(Hadley v. Baxendale (1854) 156 ER 145, 9 ExCh 341 at 354). In *Hadley v. Baxendale* millers were claiming the loss of profits caused by a breach of contract by a carrier. As a mill had to be brought to stop after a crankshaft broke down, the millers agreed on having a carrier deliver the shaft to some craftsmen in order to make a new one. However, as the defendant-carrier delayed the delivery, thereby breaching the contract, the millers claimed the lost profits caused by the delay in restarting the operation of the mill. However, as the millers had not told the carrier there was time pressure, nor was the loss of profits considered a natural consequence of the breach, the court decided that the loss of profits was to remote and hence, the carriers not liable for it. Hadley v. Baxendale established a rule that has been upheld, refined and cited in many following cases. See for instance: Black v. Baxendale (1847) 1 Exch 401, 411 (Parke J.); Victoria Laundry (Windsor) Ltd v. Newman Industries Ltd (1949) 2 KB 528; Waters v. Towers (1853) 8 Exch 401; for a more extensive discussion on the remoteness test in contract law compared to the test in tort law: *Koufos v. Czarnikow Ltd, The Heron II* (1969) 1 AC 350; *Kpohraror v. Woolwich Building Society* (1996) 4 All ER 119. In the context of investor loss: Doyle v. Olby Ltd and Others (1969) 2. Q. B. 158. See also: A. TETTENBORN e.a. (Ed.), The law of damages, London, Lexis Nexis Butterworths, 2003, 127; R. TAYLOR & D. TAYLOR, Contract law, New York, Oxford University Press, 2009, 302; H. MCGREGOR, McGregor on damages, London, Thomson Reuters, 2009, 199; HARDER, *Measuring damages*, 17, 37.

[566] The most cited case regarding causation in law in the sphere of negligence in tort is undoubtedly the *Wagon Mound* case. In Wagon Mound, the Privy Council held that causation in law should be determined on the basis of the foreseeability of the damages (Overseas Tankship (UK) v. Morts Dock and Engineering Co (Wagon Mound), A.C. 388 PC). See also: *Possfund Custodian Trustee Ltd v. Diamond* (1996) 1. W.L.R. 1351, at 1365. See also: CLERK, LINDSELL, DUGDALE and ALEXANDER, *Torts*, 78, 2-60 ff.; HARDER, *Measuring damages*, 25-26.

[567] With regard to the foreseeability requirement in the Netherlands, see for instance: Rb Amsterdam 21 December 2011, *JOR*, 2012/81, (X Holding BV/WMP NV). See also *infra*: para. 149.

have been considered to bear relatively little practical meaning.[568] It should also be noted that whereas the foreseeability and remoteness limitation apply in case damages are demanded under the UK tort of negligence, similar restrictions do not apply in case the tort of fraud is applied.[569]

150. An example may clarify the implications of the foreseeability criterion in the context of investor suits. In *Camerata v. Crédit Suisse*, Camerata had sought advice from Crédit Suisse on its investments, including structured notes issued by Lehman Brothers, and invested in the notes following a recommendation by Crédit Suisse.[570] Following the collapse and bankruptcy of Lehman Brothers, the notes lost all value. Camerata sued Crédit Suisse for negligence as the advice it had been provided with was unsuitable in the light of Camerata's investment objectives. It was particularly argued that the investment in the notes had been made in reliance on the defendant's assessment of Lehman's creditworthiness. The court decided that regardless of the question whether the claimant had relied on the defendant's assessment of the issuer's creditworthiness, the claim should be dismissed because the loss claimed by the plaintiff was the exclusive consequence of the Lehman collapse in the US in 2008, which was unforeseeable event, rendering the loss unforeseeable and irrecoverable too.[571]

151. Loss within the scope of the duty. The UK SAAMCO-doctrine[572]. Besides foreseeability of the loss, UK tort in negligence employs other limitations on recoverable losses as well, for instance under the SAAMCO-doctrine, according to which only losses within the scope of the duty owned by the defendant are recoverable. The principle was originally established by the House of Lords in *Banque Bruxelles Lambert SA v. Eagle Star*[573] and in the joined cases: *South Australia Asset Management Corpn. V. York Montague Ltd*[574], *United Bank of Kuwait Plc. v. Prudential Property Services Ltd.*[575]

[568] Art. 1150 and art. 1151 BCC and FCC. Belgium: DUBUISSON, 'Responsabilité contractuelle', 1-51; I. DURANT, 'Le dommage réparable dans les deux ordres de résponsabilité', S. STIJNS and P. WÉRY, *De raakvlakken tussen de contractuele en de buitencontractuele aansprakelijkheid*, Brugge Die Keure 2010, (53) 82 ff. with regard to France, it has been argued that the provision became more or less obsolete: VINEY and JOURDAIN, *Traité de droit civil*, 453, para. 172-1; BRUN, *Responsabilité*, 61, para. 105; consult with regard to investor losses in particular: SPITZ, *La réparation*, 276, para. 439 ff.

[569] CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 5-40.

[570] "In other words, the only reason why Camerata has suffered any loss at all, as opposed to making a substantial profit, is because of the collapse of Lehman Brothers, which was unforeseeable." Camerata Property Inc. v Crédit Suisse Securities (Europe) Ltd. (2012) EWHC 7 (Comm.) at 102, see also at 114.

[571] *Comp*. with the decisions in Rubenstein v. HSBC Bank Plc. In Rubenstein v. HSBC, a private retail customer sought a safe investment for the proceeds of the sale of his home, if possible with a higher interest rate than standard bank deposit and readily accessible. The latter also informed the bank that he could not afford to put the principal sum at any risk. HSBC advised to invest in an AIG (Premium Access) Bond and confirmed that the investment was as riskless as a bank deposit in answer to the client's question. Later on, as Mr. Rubenstein wished to withdraw his investment in a response to the increasing market turmoil in 2008 from which AIG was also suffering, he only recovered the initial investment partially. Claiming for damages in court, the court in first instance held that the advice provided by HSBC had been negligent because bonds were not as riskless as the bank deposit. The court considered that but for the negligent advice, the client would not have invested in the bonds, implying there was causation between the wrong and the loss claimed. However, since the run on the fund and the feared bankruptcy of AIG in the aftermath of the fall of Lehman Brothers could not be considered a foreseeable event, the court held that no causation was established and no more than nominal damages could be awarded. In appeal, the decision was reversed however, as the appellate court held that the causal connection between the negligent advice and the loss suffered was established, since the client had clearly indicated to prefer an investment as riskless as a bank deposit. As a result, it was within the duty to protect the client against exposure to market forces, including the financial crisis. It is the kind of loss that must be foreseeable according to the court, not the extent of the loss. The loss is therefore not too remote and must be compensated for by HSBC. Rubenstein v. HSBC Bank Plc (2012) EWCA Civ 1184.

[572] SAAMCO is an acronym that refers to South Australia Asset Management Corp. The latter was the plaintiff in the decision handed down by the UK House of Lords in which the doctrine was developed. (South Australia Asset Management Corp. v York Montague Ltd and Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd (1997) AC 191.)

[573] Banque Bruxelles Lambert SA v. Eagle Star (1997) A.C. 191.

[574] South Australia Asset Management Corpn. V. York Montague Ltd (1997) A.C. 191.

[575] United Bank of Kuwait Plc. v. Prudential Property Ltd (1997) A.C. 191.

and *Nykredit Mortgage Bank Plc. v. Edward Erdman Group Ltd*[576]. In these cases, professional valuers had negligently overvalued the property offered as security for a mortgage loan. Partially as a consequence of a severe fall in the property market in the early 1990s, and partially due to an overvaluation of the property at the time of valuation, the lenders were left with considerable losses when the borrowers defaulted and the securities were consequently liquidated. As the borrowers had little to no money left, the banks/lenders directed their claims for the outstanding parts of the loans to the valuers of the property, suing them for breach of their duty to accurately value the property. As the banks contended that they would not have lent any money at all had they known the valuations were inflated, they claimed the whole of their losses, including the part due to market circumstances.

152. The case was brought before the House of Lords that decided that that the scope of the duty of care should be starting point for the determination of the recoverable loss. Lord Hoffmann laid down a general principle contending that when a person is under a duty to take reasonable care to "provide information for the purpose of enabling to decide upon a course of action", that person is, if negligent, not generally regarded as responsible for all the consequences of that course of action. He is responsible only "for all the foreseeable consequences of the information being wrong".[577] This principle, according to Lord Hoffmann, distinguishes on the one hand the duty to *provide information* for the purpose of enabling someone else to decide upon a course of action, and on the other hand the duty to *advise* someone as to what course of action he should take.[578] Only in the latter case, the adviser should take reasonable care to consider the potential consequences of the course of action, hence the liability for the losses as a result of negligent advice should include all foreseeable loss as a consequence of that course of action.[579] In the case of the mere provision of information however – as was the case in the decision at hand regarding the valuation – the adviser should only guarantee the correctness of the information. Hence, in case of negligence, the advisor is only responsible for the foreseeable consequences of the inaccurate information.[580] Since the fall in the market, even though foreseeable, was not caused by the wrong estimations by the valuers, the latter should not be considered liable for that part of the loss as there is no sufficient causal connection with the subject matter of their duty. The SAAMCO-doctrine in effect excludes losses stemming from market actors and other factors not directly related to the wrongdoer's erroneous information (as opposed to cases concerning erroneous advice). The principle applies both in contractual and tort law and can be considered a general restriction on compensatory damages for negligent misinformation.[581]

153. Although the SAAMCO-principle was developed in the context of valuation and property, there is a parallel with securities litigation as investor losses are invariably impacted by changing market circumstances.[582] Drawing conclusions from the available case law on the impact of the SAAMCO-

[576] Nykredit Mortgage Bank Plc. v. Edward Erdman Group Ltd. (1997) A.C. 191.

[577] South Australia Asset Management Corp. v York Montague Ltd and Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd (1997) A.C. 191, at 214.

[578] Idem, at 214.

[579] Idem, at 214.

[580] Idem, at 214. Lord Hoffmann does provide some space for potential exceptions to this principle, thereby referring to the possible exception of fraud. In cases of fraudulent misrepresentation, the House thus leaves room for an exception and liability for the whole of the loss as a consequence of the fraudulent actions.

[581] A. BURROWS, *Remedies for torts and breach of contract,* New York, Oxford University Press, 2004, 109. See for a discussion also: HARDER, *Measuring damages*, 30-34.

[582] In Rubenstein for instance, the defendant argued that the losses suffered as a result of arose as a result of the extraordinary market conditions which arose in September 2008 and the collapse of Lehman Brother in particular, could not be considered recoverable in the light of SAAMCO. As the court however considered that the defendant had assumed as advisory role vis-à-

principle in the context of prospectus liability and respectively institutional asset management, ARONS and VAN SETTEN conclude that losses exclusively due to the general stock market decline are irrecoverable, regardless of whether the investments were made in reliance on unsuitable advices or following other violations.[583] The finding that the loss suffered is not within the scope of the defendant's duty of care suffices to reject the claim.[584]

154. As was the case with the foreseeability restriction, the SAAMCO-doctrine is confined to damages claimed under the tort of negligence and does apply in case of deceit. The underlying rationale for the different treatment with regard to the measurement of damages in deceit is prompted by policy considerations, as Lord STEYN indicated in *Smith New Court Securities*.[585] Appraising the justification for the distinction between deceit and negligence, it was concluded that the distinction was motivated by two particular reasons. It is particularly stressed that "it is a rational and defensible strategy to impose wider liability on an intentional wrongdoer" because of its "deterrent purpose in discouraging fraud".[586] Secondly, the distinction is defended by holding that "between the fraudster and the innocent party, moral considerations militate in favor of requiring the fraudster to bear the risk of misfortunes directly caused by his fraud."[587] Hence, tort claims based on fraud are likely to result in more considerable awards of damages than those based on mere negligence as a result of the different treatment.

155. Germany: causal adequacy test. – Similar to the UK theory on foreseeability is the German adequacy-test, which implies that the wrongful act is the adequate cause of the damage inflicted.[588] The adequate cause has been defined as "*a fact in general and not only under abnormal, completely improbable and in the ordinary course of things neglectable circumstances would have led to the occurrence of the result that happened"* by the German Federal Supreme Court.[589] Others have described the adequacy test as the requirement that only the damage which normally, in terms of common sense and experience, result from the wrongful acts.[590] Summarized, foreseeability of the

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vis the claimant-investor, rather than merely providing information, the defense was rejected without further analysis on its merits. Rubenstein v. HSBC Bank Plc (2011) EWHC 2304 (QB) at 108 ("Rubenstein (2011)").

583 ARONS, *Cross-border Enforcement*, 217; VAN SETTEN, *'The law of institutional investment management'*, 109, para. 3.82. Note that the formulation of losses due to market evolutions in the context of investor losses is somewhat confusing as investor losses are invariably the result of (changing) market circumstances. What is precisely meant with the reference to market tendencies is the distinction between losses that would have been suffered in any investment at a given point in time, as opposed to the loss suffered as a result of a particular investment to which the investor has been induced with negligent or incomplete information. See also: Camerata Property Inc. v Crédit Suisse Securities (Europe) Ltd. (2012) EWHC 7 (Comm.) at 102, see also at 114, where references to the SAAMCO-holding were made.

584 CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, para. 6-55 ff.

585 Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254, at 279.

586 Idem, at 279, F-H.

587 Idem, at 280, B.

588 The German approach to causation is often referred to as the theory of adequacy and only considers so-called 'adequate causes' relevant with regard to the imposition of liability. Adequate causes are understood to be the causes necessary to the emergence of the loss insofar the loss they caused is normal and reasonably foreseeable in an ordinary course of events. PALANDT (ed.), *Bürgerliches Gesetzbuch*, 268-269, para. 57; (with regard to investor claims for inadequate advice) BAMBERGER, 'Anlageberatung', (1407) 1468, para. 88. See also from a comparative perspective: More extensively: BRUN, *Responsabilité*, 143 ff.; VAN QUICKENBORNE, *Oorzakelijk verband*, 18 ff.; MARKESINIS, *German Law of Torts*, 103-106; D. FAIRGRIEVE and F. G'SELL-MACREZ, 'Causation in French law: pragmatism and policy', R. GOLDBERG, *Perspectives on causation*, Oxford, Hart Publishers, 2011, 118.

589 BGH 14 October 1971, 57 *BGHZ* 137, 141; BGH 4 July 1994, (1995) *NJW* 126, 127. See also: H. COUSY and A. VANDERSPIKKEN, 'Causation under Belgian law', J. SPIER, *The unification of tort law: Causation* Dordrecht, Kluwer, 2000, 65 and references cited in ftn. 11.

590 H. BOCKEN, "Actuele problemen inzake het oorzakelijk verband", in X., Recht halen uit aansprakelijkheid, Post universitaire cyclus Willy Delva 1992-1993, Gent, Mys & Breesch, 1993, n°5.

emergence of loss is of overriding importance in the legal causation test in German non-contractual law and is generally assessed in the light of factors such as probability and reasonableness and the degree with which the tortfeasor increased the probability of the occurrence of the loss.[591] In the context of investment suits, the adequacy test implies that it is considered whether the breach could be expected to result in the loss according to the ordinary course of events and 'general experience of life'.[592] For instance, assessing an investor claim directed against a financial advisor who had insufficiently advised and warned on the risks relating to trading in derivates, the Frankfurt appellate court held that the causal link between the unsuitable financial advice and the purchase of 2000 option contracts was sufficiently adequate, even though the advice had only considered the purchase of 200 to 250 of these financial instruments.[593] The court particularly held that the defendant had neglected to warn the investor about foreseeable risks ('*vorhersehbares Risiko'*) related to the purchase of such instruments – and hence the foreseeable possibility that (considerable) losses may emerge – which caused the investor to purchase the option contracts.[594]

156. Contrary to most jurisdictions, the Dutch civil law codification provides for some indications on the requirement of causation in the context of tort law.[595] According to HARTKAMP & SIEBURGH, the requirement of causation was deliberately drawn up in broad wordings in order to allow for flexibility and policy considerations.[596] The legal provision laid down in art. 6:98 DCC indicates that several factors, such as the nature of the damage and of the liability, play an important role in the assessment of the causal relation. Additionally, foreseeability also remains an influential factor, according to the scholarly literature and the case law.[597] The rather wide range of factors to be taken into account in the Dutch legal causation test grants the courts considerable power and discretion as to how the causation test should be applied. In a decision handed down by the Amsterdam court of first instance for example, an investor suffered losses following investments that had been made on his behalf by an asset manager, although the latter had not been authorized to invest the client's money in that kind of funds.[598] After it had been established that the asset manager violated contractual guidelines, it was also established that the loss did not result from general market downturns or other external factors, but had mainly been the result of third party fraud, in which the asset manager had no part. The asset manager argued that he could not be blamed for the loss since the loss had arisen because of a third party fraud of which he was not and could not have been aware. Since the occurrence of th**e** fraud had not been foreseeable or predictable either, the defendant argued that no

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[591] In the context of investor suits (asset management): CASPER and ALTGEN, 'Germany', 124, para. 4.116. See also: TREITEL, 'Remedies for breach', 66, n° 92; U. MAGNUS, 'Germany', J. SPIER, *Unifciation of Tort Law: Causation*, London, Kluwer Law International, 2000, 65 (ftn. 11).

[592] WEBER, 'Anlägeschaden', 144.

[593] OLG Frankfurt, 10 December 1992, *WM* 1993, 684, also discussed by POTTHOFF, 'Aufklärungs- und beratungspflichten', 1321.

[594] Although the court does not elaborate on its reasoning, it seems that the court considered that the purchase of 2000 options was adequately related to the wrongful advice because the emergence of loss as such (which is something else than the exact scope of the loss) had been foreseeable. For a critical opinion on this decision in the light of causation and the causation test: *Ibid.*,1321.

[595] Art. 6:162 DCC, complemented with the provisions in art. 6:163 DCC and art. 6:98 DCC.

[596] HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 63. Other commentators have also underlined that attribution is based on normative assessments rather than considerations based on mere facts. Whether or not it is reasonable to attribute the loss to the defendant is the main criterion to decide on the matter. See for instance: ARONS, *Cross-border Enforcement*, 77.

[597] HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 69. Zie ook: DE JONG, *Schade door misleiding*, 54.

[598] Rb Amsterdam 21 December 2011, *JOR,* 2012/81, (X Holding BV/WMP NV), r.o. 4.15-16.

sufficient causal link between his wrongdoing and the emergence of loss had been established.[599] The court rejected the defense, finding that the lack of compliance and overview on the side of asset manager had exposed the assets of the claimant-investors to unintended and considerable risks**.** Upon the materialization of one of those risks, the court considered the financial service provider responsible for the loss suffered as a result**.**

157. Relativity requirement and '*Schutzgesetz*'. – In addition to other limitations on recoverable loss set by the factual and legal causation requirement, some jurisdictions also apply a relativity requirement ('*relativiteitsvereiste'*, '*Schutznormlehre'*).[600] In the Netherlands and Germany, it is commonly accepted that loss can only be recoverable to the extent the obligation or rule that has been breached was intended to prevent the emergence of the loss inflicted on the victim.[601] Or in other words, to the extent the violated obligation does not serve to protect against the inflicted loss, no liability is to be imposed based on the violation of that rule. In the context of investor litigation, several examples are available illustrating *Schutznorm*-effect. In Germany for instance, §20a WpHG prohibits to carry out abusive market practices. Since the German Supreme Court judged that the provision has not been considered as a protective norm in the sense of §823 abs. 2 however, investor cannot file claims based on this provision for losses suffered following alleged market abuse.[602] According to the German Supreme Court, §20a WpHG is predominantly aimed at the orderly functioning of the market, which fails to include a legal basis for liability claims for individual investors but instead only addresses the supervisory authorities. Note however that to the extent it concerns losses suffered as a result of misleading or untimely ad hoc disclosures or periodic information, other causes of action are available under German law.[603]

158. The 'theory of equivalence': the Belgian exception? – Belgian tort law has been argued to take an exception position in terms of its approach to causation since Belgian courts consider the requirement of causation as a mere factual concept and does not include the traditional second leg of the causation test. Or that is at least the theory, repeatedly confirmed by the Belgian Cour de Cassation.[604] The Belgian theory of causation (as applied in tort law) is referred to as the 'theory of

[599] The losses recorded with regard to the investment in the Fairfield Sigma A fund were excluded since the fund turned out to be a feeder fund in the fraudulent investment business of BERNARD MADOFF, who was sentenced to prison for operating a Ponzi scheme in the US.

[600] Art. 6:163 DCC and art. 6:98 DCC with regard to the Netherlands. See also: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, vol. 6.II, para. 63.

[601] BUSCH, 'Why MiFID matters to private law', (1) 6 ff.; see for example: Hof 's-Gravenhage, 28 February 2008, *JOR* 2008/104; Rb Haarlem, 30 May 2012, LJN BW9858, available at www.zoeken.rechtspraak.nl.

[602] BGH, 13 December 2011, XI ZR 51/10, available at: http://juris.bundesgerichtshof.de; see also: *BB* 2012, 530 with comment by O. MÜLLER-MICHAELS, 'BGH verschärft Haftung bei unterlassener Ad-Hoc-Mitteilung', *BB* 2012, 537-538. See for a discussion of the decision also: A. HELLGARDT, 'Praxis- und Grundsatzprobleme der BGH-Rechtsprechung zur Kapitalmarktinformationshaftung', *DB* 2012, heft 12, 673-678. See on the actionability of §20a WpHG also: OLG Düsseldorf, 7 April 2011, I-6 U 7/10, *BB* 2011, heft 40, 2466. The literature already casted doubts on the actionability of §20a WpHG before this decision was issued. See also R. VEIL and M. WUNDENBERG, *Englisches Kapitalmarktrecht*, Köln, Wolters-Kluwer, 2010 83 and references cited with regard to court decisions related to the topic. With regard to the references and court decisions cited: note that at §20a WpHG now prohibits market price manipulation, whereas it was laid down in §88 BörsG before.

[603] See infra, para. 187.

[604] Cass. 24 March 1999, *Arr. Cass*. 1999, 177; Cass. 18 June 2010, www.cass.be; Cass., 30 April 2003, www.cass.be; the theory of equivalent conditions goes back to H. DE PAGE, Traité élémentaire de droit civil belge, 1960, II, nr. 960 and has been accepted by the Belgian Supreme Court since. See also: H. BOCKEN, "Toerekening van aansprakelijkheid op grond van de equivalentieleer", in B. TILLEMAN en I. CLAEYS (eds.), Buitencontractuele aansprakelijkheid, Brugge, Die Keure, 2004, 227; BOCKEN and BOONE, 'Causaliteit', 1634; CORNELIS, 'Ongeschikt voor overgevoelige juristen', nrs. 5 en 17; DUBUISSON, 'Jurisprudence récente de la Cour de Cassation sur la relation causale', 746-747; VAN QUICKENBORNE, VANDENBERGHE, WYNANT and DEBAENE, 'Het oorzakelijk verband', 1878, nr. 145; BOCKEN, 'Causaal verband in het Belgische recht', 127 ff.

equivalence', which implies that all the elements that are found to be necessary conditions to the emergence of the damage as it occurred, are considered to be equally causally related to the damage, without further distinctions.[605] This approach is generally considered victim-friendly and defended from a policy perspective because it imposes liability for losses on wrongdoers, which may be deemed unfair or even harsh in certain circumstances, yet still preferable over a system that leaves the loss with the victim, who is considered even less responsible for the occurrence of the loss.[606]

159. Notwithstanding the theoretical indifference towards normative criteria however, case law has demonstrated that courts do not apply the principle as straightforward as the theory may suggest and still take normative criteria and policy considerations into account.[607] Despite regular interventions of the Belgian Supreme Court to reject decisions that depart from the strict application of the theory of equivalence[608], some decisions made it through the supervision by the highest court regardless of deviations from the traditional Belgian causation theory.[609] This is for instance clearly illustrated in a case where the defendant accidentally lost control of the vehicle he was driving at night, hit various cars in the street as a result, and rode off. The noise awoke one of the car owners, who became unwell and fell to the ground when his wife told him their car had been hit. The car owner died in the hospital the same night. Although the factual causal relation between the accident and the decease of the car owner is clear, the Brussels Court of Appeal ruled that the decease could not be considered causally related to the breach as it was not a normal consequence of a car accident.[610] Under a strict interpretation of the theory of equivalence, it does not matter whether a consequence is normal, typical or foreseeable, since only factual causation is required.[611] The decision was nonetheless confirmed by the Belgian Supreme Court.[612] This example along with others has led scholars to conclude that the Belgian concept of causation and its implementation in practice does not appear radically different from the approaches used in other jurisdictions.[613]

160. **France. –**The French Civil Code refers to the requirement causation in terms of an 'immediate and direct consequence' (*une suite immediate et directe'*) of the contractual breach, but little can be

[605] Cass. 20 December 1996, Arr. Cass. 1996, 552; *Cass*. 25 March 1997, *Arr. Cass*. 1997, 61; Cass. 23 November 1999, *Arr. Cass*. 1999, nr. 623; *Cass*. 21 February 2001, www.cass.be; see also: H. BOCKEN, "Actuele problemen inzake het oorzakelijk verband", in X., Recht halen uit aansprakelijkheid, Post universitaire cyclus Willy Delva 1992-1993, Gent, Mys & Breesch, 1993, n° 1-15; BUSSANI and PALMER, 'Liability regimes of Europe', 131 ff; DUBUISSON, 'Jurisprudence récente de la Cour de Cassation sur la relation causale', 746-747.

[606] RONSE, *Schade en schadeloosstelling*, 170, para. 225; 176 para. 236.

[607] H. BOCKEN, 'Actuele problemen inzake het oorzakelijk verband', in X., *Recht halen uit aansprakelijkheid*, Post universitaire cyclus Willy Delva 1992-1993, Gent, Mys & Breesch, 1993, n°6; BUSSANI and PALMER, 'Liability regimes of Europe', 131-133; VAN QUICKENBORNE, VANDENBERGHE, WYNANT and DEBAENE, 'Het oorzakelijk verband', 1877, nr. 144 ff.; BOCKEN, 'Causaal verband in het Belgische recht', 130 ff.; J. SPIER, 'Causation', EUROPEAN GROUP ON TORT LAW, *Principles of European Tort Law*, Wien, Springer, 2005, 43; KLEINSCHMIDT, 'Causation', 157. See also: Gent, 14 April 1998, *T. Gez*. 1999-2000, 57, annotated by J. TER HEERDT, stating that regardless of whether the theory of equivalence or the theory of the adequate cause was applied, the result would be the same.

[608] For instance: *Cass*. 27 March 1980, *Arr. Cass.* 1979-80, 946; *Cass*. 26 February 1981, *Arr. Cass*. 1980-81, 727; *Cass*. 5 March 1953, *Pas*. 1953, I, 516: *Cass*. 3 February 1987, *RW* 1987-88, 220; *Cass*. 24 December 1947, *Pas*. 1947, I, 555; Brussel, 24 February 1989, *R.G.A.R*. 1990, 11618, with ann. by GLANSDORFF.

[609] H. BOCKEN, 'Actuele problemen inzake het oorzakelijk verband', in X., *Recht halen uit aansprakelijkheid*, Post universitaire cyclus Willy Delva 1992-1993, Gent, Mys & Breesch, 1993, n°6; BUSSANI and PALMER, 'Liability regimes of Europe', 131-133; VAN QUICKENBORNE, VANDENBERGHE, WYNANT and DEBAENE, 'Het oorzakelijk verband', 1879, nr. 146; BOCKEN, 'Causaal verband in het Belgische recht', 130 ff.

[610] Brussel, 24 February 1989, *RGAR* 1990, 11.618

[611] See in a similar sense: F. GLANSDORFF, in a comment on *Cass*. 11 October 1989, *RGAR* 1992, 12.007.

[612] *Cass*. 11 October 1989, *RGAR* 1992, 12.007, with ann. by F. GLANSDORFF.

[613] See the references cited in ftn. 609. See also: KLEINSCHMIDT, 'Causation', 157.

added as there is no further clarification, besides the assumption that this requires at least a 'conditio sine qua non' or factual causal relation, as is common.[614] Whether and how normative assessments are carried out to determine the outlines of recoverable losses is less clear however.[615] Even though the scholarly literature discusses the French causation doctrine in certain terms, such as 'theory of equivalence' and adequacy theory, the Cour de Cassation has not employed these terms.[616] Yet overall, it is accepted that regardless of the absence of dogmatic definitions, assessment of causation is carried out by an inquiry into the factual causal link while normative considerations may play a role as well.[617]

C. Causation and recoverable loss in the context of investor litigation

161. The preceding section explained the theories and conceptual notions of recoverable loss and causation according to the Member States' general liability laws. In the light of the subject of this thesis and to clarify the structure employed in the next chapters, it may be instructive to apply these concepts to determine the outlines of what constitutes a recoverable investor loss.[618]

162. The dual notion of causation: transaction and loss causation. – In the context of unsuitable advice, inadequate information, misleading disclosures etc., claims are generally centered on the allegation that the violation caused the investor to decide to invest in particular securities or lead him to agree on a certain strategy. In absence of the wrong, another investment decision would have been made, which would have precluded the loss suffered as a result from the distorted investment decision. From this perspective, the notion 'causation' is two-pronged again as it is argued that the breach has resulted in (1) a transaction or investment based on an investor's distorted consent, (2) which then caused the loss to emerge. Put differently, transaction causation answers the question *if* losses were suffered as a result of the alleged wrong, while loss causation is aimed at the question *how much* loss has been suffered as a result of the wrongful conduct. In common law countries this dual approach to causation is generally referred to as 'transaction causation' and 'loss causation'.[619] Transaction causation implies a causal link between the unsuitable advice and the client-investor's informed consent. As transaction causation requires that an investor relied on information or advice to make a

[614] The 'immediate and direct consequence' in the contractual context is based on art. 1151 French Civil Code, which is the exact same article, both in words and in article number, as can be found in the Belgian Civil Code.

[615] BRUN, *Responsabilité*, 143, para. 278 (and ftn. 8) and para. 291; BANAKAS, 'Liability for Incorrect Financial Information', 264-265; FAIRGRIEVE and G'SELL-MACREZ, 'Causation in French law', 113; BOCKEN and BOONE, 'Causaliteit', 1628, nr. 3; CARTWRIGHT and HESSELINK (eds.), *Precontractual Liability*, 31.

[616] BRUN and QUÉZEL-AMBRUNAZ, 'French Tort Law', 87; S. GALAND-CARVAL, 'France', U. MAGNUS, *Unification of Tort Law: Damages*, The Hague, Kluwer Law International, 2001, 54; BANAKAS, 'Liability for Incorrect Financial Information', 264.

[617] FAIRGRIEVE and G'SELL-MACREZ, 'Causation in French law', 111-129. See also: E. WYMEERSCH, 'Bank liability for improper credit decisions in the civil law', R. CRANSTON, *Banks, Liability and risk*, London, LLoyd's of London Press 1995, (179) 207; HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, n°. 52; BANAKAS, 'Liability for Incorrect Financial Information', 264; BRUN and QUÉZEL-AMBRUNAZ, 'French Tort Law', 86-89. For an extensive and detailed study of the concept of causation in French law: C. QUÉZEL-AMBRUNAZ, *Essai sur la causalité en droit de la responsabilité*, Paris, Dalloz, 2010.

[618] Requirements other than causation and loss are not considered in more detail as this would go beyond the subject of this thesis. The existence of a wrongful act is assumed.

[619] Notably the US and the UK. (US) Suez Equity Investors, L.P. v. Toronto-Dominion Bank, No. 99-9042 (2d Cir. May 8, 2001); Dura Pharmaceuticals, Inc. v. Broudo (03-932) 544 U.S. 336 (2005), at 339. UK: (specifically with regard to fraudulent misrepresentations): "The courts have drawn a distinction between the test for causation in relation to the claimant's reliance on the misrepresentation, and the test for causation in relation to the loss he suffers in consequence of that reliance." CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 224, para. 5-38; FERRAN, 'US-style investor suits', 325 ff.. See also: C. VON BAR (ed.), *Non-contractual Liability Arising Out of Damage Caused to Another: (PEL Liab. Dam.)*, Munich, Sellier, 2009, 513 on the two-pronged nature of causation in the context of erroneous advice or information.

transaction or investment, the concept is also known and referred to as 'reliance'.[620] Loss causation on the other hand concerns the causal relation between the breach and the damages claimed.

163. Whereas this two-pronged approach is acknowledged and used in common law countries, most European legal systems have not explicitly acknowledged or employed the concepts, although courts and academic literature are increasingly adopting the terminology to distinguish between the two concepts and avoid confusion about what the term 'causation' exactly covers.[621] An exception to the latter observation is Germany, however, where a dual notion of causation has been longstanding and is frequently used by commentators.[622] This understanding of causation known in German (and Swiss) law and is referred as '*haftungsbegründende Kausalität*' (or liability constituting causation) and the *'haftungsausfullende Kausalität'* (or liability completing causation).[623] '*Haftungsbegründende Kausalität*' requires a causal relation between wrongdoing and an infringement of the claimants' protected right, while '*haftungsausfullende Kausalität'* requires a causal nexus between the defendants' harmful act and the claimed loss. In the context of investor suits, the requirement of '*haftungsbegründende Kausalität*' is interpreted as the causal connection between breach and the investor's individual right to come to an informed decision[624], whereas '*haftungsausfullende Kausalität'* implies the causal link between the breach and the loss claimed.

164. Materiality v. reliance/transaction causation. – Transaction causation requires that investors rely on the unsuitable advice or recommendations or the deficient issuer information, in the sense that the information must affects – or would have in case of an omission – the decisions they make. The impact of information on investment decisions can be considered on two levels, being an abstract, theoretical assessment in terms of its significance for a fictitious average and reasonable investor to whom the disclosure was directed, or a factual assessment in the light of the individual investor and the particular circumstances of the case. The abstract assessment of the relevance of the information

[620] CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 3-51.

[621] See for instance with regard to the Netherlands: DE JONG, *Schade door misleiding*, 2010; B. DE JONG, 'Liability for Misrepresentation - European Lessons on Causation from the Netherlands', 8 *Eur. Company & Fin. L. Rev.*, 2011, 355; ARONS, *Cross-border Enforcement*, 232-233. Belgium: VANDENDRIESSCHE, 'Fraud-on-the-market', 277; VANDENDRIESSCHE, 'Causaliteit en bewijslast', 190; Germany: WAGNER, 'Schadensberechnung', 504 ff. For a comparative overview, see also the conclusion drafted by (the Dutch) Advocate-General L. TIMMERMANS: r.o. 4.5.2.7 , Concl. A.-G. TIMMERMANS, HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht* 2010, 21, with ann. by H.M. VLETTER-VAN DORT.

[622] See for instance: ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 176; HELLGARDT, *Kapitalmarktdeliktsrecht*, 519; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 96-97; HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation,* §29, para. 35 and 49. See in this regard also: ARONS, *Cross-border Enforcement*, 164.

[623] Germany: Required by general tort law provisions such as §823 Abs. 2 BGB and §826 BGB for instance. See also: PALANDT (ed.), *Bürgerliches Gesetzbuch*, vor v §249 BGB, para. 54; MAGNUS, 'Germany', 63-64; see extensively: R. ZIMMERMANN and J. KLEINSCHMIDT, 'Haftungsbegründende und haftungsausfullende Kausalität', in B. WINIGER, H. KOZIOL, B.A. KOCH and R. ZIMMERMANN (eds.), *Digest of European Tort Law*, Vol. I. Essential cases on natural causation, Wien, New York, Springer, 2007, 593-611. Switzerland: ROSAT, *Der Anlageschaden*, 33; WEBER, 'Anlägeschaden', 145; see also ZIMMERMANN and KLEINSCHMIDT, 'Haftungsbegründende und haftungsausfullende Kausalität', 593 ff. (chapter 11).

[624] According to courts and literature, capital market disclosure and information obligations are intended to allow investors to make informed decisions. As a result, investors are entitled to reach their own decisions and have the right to dispose over their property and assets as they wish ("individuelle Dispositionsfreiheit des Anlegers"), independent from unfair and improper influence that distorts their consent and individual decision process ("unlauteren Einfluss auf seine Willensbildung" or "Willensfreiheit"). See in this regard: HELLGARDT, *Kapitalmarktdeliktsrecht*, 519-520, explaining that the protected right ("Schutzgut") in capital market disclosure obligations concerns the right to freely decide ("*Willensfreiheit*) and/or the right to trade in honest, unmanipulated markets. See also: BGH, 13 December 2011, XI ZR 51/10, (IKB), *BB* 2012, 530 with ann. by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537-538; and (with regard to ad hoc information obligations laid down in §§37b, c WpHG): H. HIRTE and T.M.J. MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, Köln, Heymanns, 2007, §§37b, c WpHG, para. 11; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 131; HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 56 ff.

on the decision process is an objective standard to be assessed from the point of view of the reasonable investor and generally referred to as the materiality requirement. Reliance on the other hand is the subjective test that aims to determine whether a particular individual investor in the given circumstances took (or – in case of omissions – would have taken) the information into account to make a decision.[625]

165. In the Member States both materiality and reliance are genuinely relevant in misrepresentation cases. As already explained, reliance (or interchangeably transaction causation) constitutes the first prong of the causation test in misrepresentation cases. Materiality on the other hand concerns the evaluation of the alleged wrongful behavior in the sense that only to the extent that the information is material it can be inferred that the investor public has been deceived and hence that the defendant acted wrongfully.[626] As such, materiality is essential to assess the misleading nature of the misrepresentation and to establish a wrongful act on the side of the defendant. Although an abstract assessment of the material nature of the misinformation may to some degree simplify and facilitate the judicial analysis, courts in the Member States have displayed reluctance to assess causation through an abstract assessment based on the average circumspect and reasonable investor.[627] The reluctance seemingly lies with the traditional and firmly rooted principle that the requirements of loss and causation must be appraised with regard to the concrete facts of the case and the principle that damages are recoverable only to the extent that a particular claimant-victim truly suffered losses. Other objections raised in this respect refer to the consequences and implications of an abstract assessment, being that as soon as the misleading nature of the information at matter has been established vis-à-vis a (hypothetical) average investor, individual claimants may obtain compensation regardless of whether or not they actually relied on the information.[628] As a result, courts have insisted on the requirement of reliance and shown reluctance to be satisfied with mere materiality.

166. Transaction and loss causation: ambiguity in the case law. – In those cases where the investor-client's informed consent is disputed, the twofold causation requirement is clearly

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[625] See with regard to the concepts of reliance and materiality in securities litigation also: M.J. KAUFMAN and J.M. WUNDERLICH, 'Fraud created the market', 63 *Ala. L. R.*, 2012, 280; ARONS and PIJLS, 'Prospectus liability in the Netherlands', 468; SPITZ, *La réparation*, 272, para. 435.

[626] With regard to prospectuses, see for instance art. 5 (1) Prospectus Directive that holds that "the prospectus shall contain all information which, according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment […]". The 'necessary information'-requirement is also commonly referred to as 'material' in the literature and case law, in line with the common law countries where materiality has been a longstanding requirement in misrepresentation cases. See for instance: (the Netherlands) T.M. STEVENS, 'Prospectusplicht (II): inhoudelijke vereisten', B. BIERENS, C.M. GRUNDMANN-VAN DE KROL, D.J.R. LEMSTRA and T.M. STEVENS, *Handboek Beursgang*, Deventer, Kluwer, 2011, 169 ff.; ARONS, *Cross-border Enforcement*, 56, 65; specifically on the relation between materiality and reliance: ARONS and PIJLS, 'Prospectus liability in the Netherlands', 468-470. (Belgium) Art. 24, 44 Prospectuswet, see also: RAVELINGIEN, Privaatrechtelijke handhaving, 427. (UK): s.87 FSMA; see also: HUDSON, *Securities Law*, 592, para. 23-39 ff.; T.M.C. ARONS, *Cross-border Enforcement of Listed Companies Duties to Inform*, Kluwer, 2012, 205. (France): SPITZ, *La réparation*, 271-272. (Germany) ('*Wesentlichkeit'*) M. HABERSACK, P.O MÜLBERT and M. SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, Köln, Otto Schmidt KG, 2008, §33, para. 42; E. SCHWARK and D. ZIMMER, *Kapitalmarktrechtskommentar*, München, Beck, 2010 §§ 44,-45, para. 25 ff. With regard to ad hoc-disclosure: (the Netherlands) art. 5:53 Wft; STEVENS, 'Prospectusplicht (II)', 171; DE JONG, *Schade door misleiding*, 32. (France): SPITZ, *La réparation*, 271-272; (Germany) HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 193.

[627] SPITZ, *La réparation*, 271-272; ARONS and PIJLS, 'Prospectus liability in the Netherlands', 471-472. This is for instance also illustrated in the German collective action system, in which it can be decided via a collective procedure whether or not the defendant acted wrongfully and whether or not the omission or disclosure was material, however with regard to the assessment of causation and damages, individual claims must be filed. See also: E. FEESS and A. HALFMEIER, 'The German Capital Markets Model Case Act (KapMuG)- a European role model for increasing the efficiency of capital markets? Analysis and suggestions for reform', 2010, Available at SSRN: http://ssrn.com/abstract=1684528 and particularly p. 10.

[628] SPITZ, *La réparation*, 271-272.

distinguishable and thus requires the courts to analyze and assess the requirements of causation accordingly.[629] The requirement of transaction causation is met when the claimant would have made another investment decision in absence of the wrong. To the extent an identical decision would have been taken, no causation exists between the wrong and the loss. Secondly, once it has been clarified that another decision would have been made, it must be determined (1) what alternative decision would have been made and (2) to what extent a different result would have been achieved in this alternative scenario. It was already indicated in the section on recoverable loss that a number or alternative scenarios may be thought of, being that (1) the investor might have decided to abstain from investing once he had been duly informed on or warned for the risks investments carry; (2) it may be that the investor would have chosen a more appropriate and suitable investment in the light of his objectives and profile, which will be the most alternative situation in case of advice or asset management; (3) in case of market disclosures, a third scenario is possible because of the particular fact that market disclosures – contrary to unsuitable advice or defective asset management – may influence securities prices. More particularly, in the context of disclosures to the market, it may be that absent the deficient information, investors would have traded against a more favorable price. The concepts of transaction causation and loss causation are substantially different concepts and hence associated with different sets of problems. The distinction between those two elements of the causation requirement is therefore a dividing line in the analysis of causation in next chapters of this thesis.

167. Prior to analyzing these scenarios and their implications in the next chapters, it is pointed out that courts have not always consequently followed the outlines as set out in the previous paragraphs and sections. Rather than making the comparison with the (hypothetical) alternative investment the investor would have made absent the wrong, courts have focused on the investor's initial investment and consider the total depreciation in investment value as recoverable loss, regardless of whether the investor would or would not have made an alternative investment – which may caused him to suffer losses as well – absent the wrong. A notable example is the decision of the Dutch Arnhem Court of Appeal.[630] Following breaches of the duty to warn and the failure to sufficiently observe the know-your-customer obligation, the court held the defendant liable for the losses suffered as a result of speculative investments in futures and options. Rather than options and futures, a more balanced and risk neutral portfolio should have been assembled, according to the court. Assessing the defendant's argument that general market evolutions were to be blamed for the loss rather than the breach, the court stressed that the duty of care imposed on the defendant precisely aims to protect investors against market risks.[631] Considering that a general fall in market prices failed to break the causal link between the violation and the losses, the court awarded damages based on the initial investment.

[629] See for instance Book IV.C.-7:109 DCFR on causation in the context of violations of the duty to provide information or information to another party: "If the provider knows or could reasonably be expected to know that a subsequent decision will be based on the information to be provided, and if the client makes such a decision and suffers loss as a result, any non-performance of an obligation under the contract by the provider is presumed to have caused the loss if the client proves that, if the provider had provided all information required, it would have been reasonable for the client to have seriously considered making an alternative decision."

[630] Hof Arnhem, 6 July 2010, LJN BN0830, *JOR* 2010/308; also available at: http://zoeken.rechtspraak.nl. See for comparable (Swiss) decisions: BGer 4C.385/2006 E.6.4; BGE 124 III 155 (E 3d) S. 165 f.; BGer 4C.295/2006; all decisions available at: http://www.bger.ch. See also the court decisions cited in ROSAT, *Der Anlageschaden*, 147 ftn. 766 and 767.

[631] "Ter bestrijding van het causaal verband voert de bank nog aan dat de geleden verliezen volgens haar in belangrijke mate zijn veroorzaakt door de marktomstandigheden en fors dalende beurskoersen. Dienaangaande overweegt het hof dat deze omstandigheden het causaal verband tussen de schending van de zorgplicht bij het aangaan van de overeenkomsten en de geleden verliezen geenszins doorbreken. De door de bank geschonden zorgplicht strekte er immers mede toe om [appellant] voor dit soort risico's te behoeden." Hof Arnhem 6 July 2010, LJN BN0830, *JOR* 2010/308, para. 48.

Appealed before the Dutch Supreme Court however, the appellate decision was rightly quashed on this point.[632] Unless an investor would not have invested at all without the occurrence of the breach, losses unrelated to the established violation should not be compensated.[633]

168. Another example of the rather troubled view on causation is the decision handed down by the (Belgian) Brussels court of appeal with regard to an investor complaint following a failure to execute an order.[634] Despite the fact that the investor-claimant had passed an order to sell accompanied by all relevant information, the defendant failed to execute the order. The investor-claimant demanded redress for the loss suffered as a result of the missed opportunity to sell securities for a favorable price in case of timely execution of his order. Assessing the loss, the court insists that recoverable loss is only suffered to the extent the shares are sold for a price *below its initial purchase price* (emphasis added). Rather than measuring the damages in accordance with the comparison between the hypothetical situation (without fault) on the one hand and the actual situation in which wrongful conduct is taken into account as is the standard approach to assess loss, the court refers to the initial investment value to assess the existence and scope of the recoverable loss. Examples of court decisions disregarding the (proper) method to assess causation and loss and instead making reference to the initial investment value as the standard for comparison are not extremely rare.[635] One explanation for the reference to the initial investment value may lay with the difficulties that arise in constructing the hypothetical alternative with which the actual situation is to be compared. This matter is discussed in more detail in the following chapters.

D. Procedural aspects: evidential rules

[632] HR 3 February 2012, LJN BU4914, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), *JOR* 2012/116, with ann. by S.B. VAN BAALEN; *Ondernemingsrecht*, 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; also available at www.rechtspraak.nl. *Comp*. with the holding in *South Australia Asset Management Corp. V. York Montague Ltd* (1997) A.C. 191, at 218: "But in principle there is no reason why the valuer should not be entitled to prove that the lender has suffered no los because he would have used his money in some altogether different but equally disastrous venture. Likewise the lender is entitled to prove that, even though he would not have lent to that borrower on that security, he would have done something more advantageous than keep his money on deposit".

[633] As the advocate-general points out in the aforementioned case, the investor-claimant would have invested in any case for he indicates that according to his opinion, the portfolio had to be composed of 50 percent investments in shares and 50 percent in obligations. Since the tock prices are generally known to have fallen on a global scale, it cannot be assumed that the investor would have succeeded in preserving the whole investment. In this alternative scenario the investor would have suffered damages (though evidently to a lesser extent) as well. Consideration 2.29 in the Conclusion of the Advocate-General, in HR, 3 February 2012, LJN BU4914, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), *JOR* 2012/116, with ann. by S.B. VAN BAALEN; *Ondernemingsrech*, 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; also available at www.rechtspraak.nl; Rb Amsterdam, 21 December 2011, *JOR* 2012/81, (X Holding BV/WMP NV), para. 4.10. Similar: BENICKE, *Wertpapiervermögensverwaltung*, 832; See for a Swiss point of view: ROSAT, *Der Anlageschaden*, 147, 155. ROSAT correctly points out that the hypothesis that the investor would not have invested at all – and is thus entitled to a compensation based on the initial investment – is rather exceptional. GUTZWILLER, 'Unsorgfältiger Vermögensverwaltung', 64 – the author points out that despite the easier and more certain outcome a compensation based on the initial investment would be, it is not correct to apply for it does not correspond to the principles of the law of damages.

[634] Kh. Brussel, 30 June 2003, *Bank. Fin. R.*, 2004, nr. 3, 175, with ann. by DE VUYST.

[635] See also (with regard to Belgium) Kh. Brussel, 26 March 1997, *Bank. Fin. R.*, 1997/V, 334. Comp. with the approach applied in Rb. Brussel, 24 February 2012, *Bank. Fin. R.*, 2012/II, 128; the Netherlands: Hof Arnhem 6 July 2010, LJN BN0830, *JOR* 2010/308; also available at: http://zoeken.rechtspraak.nl. See for comparable (Swiss) decisions: BGer 4C.385/2006 E.6.4; BGE 124 III 155 (E 3d) S. 165 f.; BGer 4C.295/2006; all decisions available at: http://www.bger.ch. See also the court decisions cited in ROSAT, *Der Anlageschaden*, 147 ftn. 766 and 767. Making a similar remark with regard to Austria: BYDLINSKI, 'Fehlerhafte Anlageberatung', 161.

1. General principle: allocation of the burden of proof on the claimant

169. As a matter of principle, parties seeking remedies for losses caused by another party's fault are required to present evidence to support their allegations and claims in court proceedings.[636] An investor claiming losses allegedly suffered because of a breach is thus required to present proof of the alleged breach, the existence and the scope of the loss, and the causal relation between the breach and the loss claimed.[637] The evidential standard in civil matters to accept that the allegations are sufficiently proven is interpreted in the sense that the likelihood of the allegation must be such that a judge cannot seriously consider the opposite. Dutch courts for instance suffice with proof that the causal relation between the fault and the emergence of the damage is 'plausible'[638] or satisfies a 'reasonable degree of probability'[639], whereas in UK courts, evidence is weighted on 'the balance of probabilities'.[640] According to German law by comparison, the court must be fully convinced ('*volle Überzeugung*').[641] Notwithstanding these formulas however, assessment of causation remains a highly factual matter left to courts' discretion to assess and cannot really be confined in formal tests.[642]

2. Scope of the loss: assessment of damages

170. In principle, the damages should restore the harm inflicted on the victim, implying that only loss that has actually been suffered should be compensated ('*in concreto*').[643] The courts are expected

[636] In the Netherlands, this principle is laid down in art. 150 Rv. See also: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, vol. 6.II, para. 76 (with regard to causation). See on the burden of proof in the context of investor claims: HR 15 December 2006, *RvdW*, 2007, 1; with ann. by A.J. HAASJES, *V&O*, 2007, nr. 2, 24-26; see also: I.C. BLOMSMA and L.C.W.M. VAN KESSEL, Bewijs en causaliteit, R. VAN DER POEL, D. SCHEENJES and T. VAN DER WAL, *Causaliteit: top-down en bottom-up in Nederlands en transnationaal perspectief*, Antwerpen, Apeldoorn, Maklu, 2010, (13) 14 ff.; C.M.J. KLAASSEN, 'Bewijs van causaal verband tussen beweerdelijk geleden beleggingsschade en schending van een informatie- of waarschuwingsplicht', D. BUSCH, C.M.J. KLAASSEN and T.M.C. ARONS, *Aansprakelijkheid in de financiële sector*, Deventer, Kluwer, 2013, 127. Belgium: art. 1315 BCC read together with 870 Civil Procedural Code; see also: Rb. Brussel, 3 February 2011, (X./Belgian Government), *TRV* 2011, afl. 3, 199-212; BOCKEN and BOONE, *Schadevergoedingsrecht*, 54, para. 71. France: art. 1315 FCC in conjunction with art. 9 of the Civil Procedure Code (*Code de procédure civile*) require the claimant to prove his allegations and provide facts and/or indications that support his claim. See also: LE TOURNEAU, *Droit de la responsabilité et des contrats*, paras. 446, 2358; Germany: ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, 140, §4, para. 112; UK: MCGREGOR, *McGregor on damages*, 105.

[637] Idem.

[638] M.H. WISSINK and W.H. VAN BOOM, 'The Netherlands', U. MAGNUS, *Unification of Tort Law: Damages*, The Hague, Kluwer Law International, 2001, (143) 144.

[639] BLOMSMA and VAN KESSEL, Bewijs en causaliteit, 19; KLAASSEN, 'Bewijs van causaal verband', 128, 130.

[640] The threshold is set at 51 percent probability. See for instance: House of Lords, 2 July 1987, Hotson v. East Berkshire AHA, (1987), 1 AC 750; Queen's Bench Division, 11 August 2006, Garcia v East Lancashire Hospitals NHS Trust, (2006), EWHC 2062 (QB); *Hornal v Neuberger* Products Ltd (1957) 1 QB 247; Harrison v. Bloom Camillin, (2001), PNLR 195, 223; Gregg v. Scott (2005) UKHL 2. Or as it was stated by Lord DIPLOCK in *Mallett v McMonagle:* "*In determining what did happen in the past a court decides on the balance of probabilities. Anything that is more probable than not it treats as certain*." (*Mallett v McMonagle* (1970), A.C. 166 at 176). See also: MCGREGOR, *McGregor on damages*, 6-015; BURROWS, *Remedies*, 55 ff.; A. TETTENBORN, E.A. (ed.), *The law of damages*, London, Lexis Nexis Butterworths, 2003, 173, para. 7.70.

[641] L. ROSENBERG, K.H. SCHWAB and P. GOTTWALD (eds.), *Zivilprozessrecht*, München, Beck, 2004, §114, para. 7.

[642] See for a similar conclusion the following UK court decision: *Galoo Ltd. v. Bright Grahame Murray e.a.*, (1994), 1 W.L.R. 1360, at 1370, citing the literature as follows: "*courts have avoided laying down any formal tests for causation: they have relied on common sense to guide decisions as to whether a breach of contract is a sufficiently substantial cause of the plaintiff's loss. (It need not be the sole cause)*." (*Chitty on Contracts*, 26th ed. (1989), vol. 2, pp. 1128–1129, para. 1785). See in the same sense regarding causation: *Yorkshire Dale Steamship Co. Ltd. v. Minister of War Transport*, (1942), A.C. 691, at 706, *per* Lord WRIGHT.

[643] See for instance: The Netherlands: Rb Amsterdam, 11 March 2009, LJN BH6081, *RF* 2009, 76; also available at: http://zoeken.rechtspraak.nl.; see also: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 33. Belgium: Cass. 6 March 1967, *Arr. Cass.* 1967, 840; Cass. 23 October 1991, *Arr. Cass.* 1991-1992, 180; Cass. 16 February 1956, *Pas.* 1956, I, 622; Cass. 3 November 1982, *Arr. Cass.* 1982-83, 320; Cass. 18 March 1987, *Arr. Cass.* 1986-87, 944; Cass. 30 March 1994, *Arr. Cass.* 1994, 340; See also: R. O. DALCQ, *Traité de la responsabilité civile.*

to draw on the circumstances and facts of the individual case to assess the damages, yet in some circumstances, difficulties may arise when the scope of the loss is unclear or hard to assess. As soon as the existence of a recoverable loss has been proven however, the claimant is entitled to damages, which must be calculated by the court.[644] In some jurisdictions, courts may resort to a more abstract or objective assessment of the damages when they cannot be accurately and precisely measured in given cases. This implies an assessment based on the scope of the loss as it generally emerges in similar situations and under similar circumstances. The assessment on an abstract basis may be supported by generalizations and averages, or statistical evidence on the scope of a typical loss in a similar situation. Not all jurisdictions are as willing to accept objective or abstract evidence to calculate the damages. For example, Belgium has been found to take a rather relaxed stance vis-à-vis probabilities and generalizations to determine the amount of damages.[645] In those cases where no precise assessment of the damages is possible however, courts are generally allowed to decide on the scope of the damages in the light of the principles of fairness and reasonableness (‘*ex aequo et bono*’).[646]

3. Facilitations or alterations of evidential rules

171. Presumptions introduced by court or statute. – In cases where the basic principle that the claimant bears the burden of proof on causation between the alleged breach and the loss claimed has proven too much a hurdle for plaintiffs, courts and/or legislators have occasionally intervened and alleviated the evidential burden, either by evidential relaxations or causal presumptions. Presumptions of causation can for instance be found in various Member States in the context of prospectus liability since the burden of proof on causation turned out highly problematic in many prospectus liability cases.[647] Presumptions can be introduced by courts or legislators, and can either be very specific with regard to their scope of application or rather general instead.[648] Provided that evidence to the contrary is presented, presumptions are often – yet not always – rebuttable. A notable example of a causal presumption introduced by courts to facilitate investor claims is for instance the German ‘*Vermutung aufklärungsrichtigen Verhaltens’*, according to which causation between breaches of (precontractual or contractual) information or advice obligations and a plaintiff’s reliance on the information or advice is presumed.[649]

Les Novelles. Droit Civil V., part II, Brussels, Larcier, 1962, 225, n° 2821; RONSE, *Schade en schadeloosstelling*, 356; DE CALLATAŸ and ESTIENNE, *La responsabilité civile*, 67; WEINBERGER, *Gestion de portefeuille*, para. 225. Switzerland: CHAPPUIS, *Le moment du dommage*, 34.

[644] UK: BURROWS, *Remedies*, 63; Belgium: Cass. 30 March 1994, *Arr. Cass.* 1994, 340; Cass. 14 October 1940, *Pas.* 1940, I, 249. In the latter case it was decided by a lower court that the existence of damages was certain, though the assessment of put the court in a difficult position, leaving the case to be decided without the award of damages. This decision was rejected by the Belgian Supreme Court. See also: DALCQ, *Traité de la responsabilité civile*, 225, n° 2821; RONSE, *Schade en schadeloosstelling*, 356. Germany: §287 ZPO.

[645] BOCKEN, 'Causaal verband in het Belgische recht', 126. See also: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, vol. 6.II, para. 35. CHAPPUIS, *Le moment du dommage*, 35.

[646] The Netherlands: art. 6:97 DCC; HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 34. Belgium: DE CALLATAŸ and ESTIENNE, *La responsabilité civile*, 67; RONSE, *Schade en schadeloosstelling*, 357 ff.; for an example in the context of investor suits, see for instance CA Bergen, 7 October 2004, *Bank. Fin.* R. 2006/II, 94, with ann. by S. DELAEY; or: Rb. Brussel, 24 February 2012, *Bank. Fin. R.*, 2012/II, 128; BOCKEN and BOONE, *Schadevergoedingsrecht*, 225, para. 342. Germany: §287 ZPO (see also below, para. 173). See also the references cited in ftn. 644.

[647] See *infra*: para. 176.

[648] See for instance France and Belgium: art. 1349 FCC and art. 1353 FCC, respectively art. 1349 BCC and art. 1353 BCC.

[649] See *infra*: para. 200.

172. Prima facie-evidence or 'Anscheinsbeweis'. – In Germany, courts may also resort to the concept of *prima facie*-evidence, the so-called '*Anscheinsbeweis'* which means that a claimant is required to present facts and indications to render his claim plausible.[650] To the extent that common sense and experience show that the injury suffered by the claimant is a typical or logical consequence of the breach, the courts may consider causation proven. *Prima facie*-evidence does not reverse the burden of proof in other words, as is the case with presumptions, and is therefore considered less far-reaching in effect.[651]

173. §287 ZPO[652]. – A final remark concerns §287 ZPO, which is a German procedural rule that can be applied by courts to assess loss. Once it has been established that a violation occurred and that a loss has been suffered by the plaintiff, it is within the courts' discretionary powers to assess the loss according to the evidence brought before it and award damages as it sees fit based on its assessment. §287 also allows the court to accept evidence in this regard based on the balance of probabilities, instead of the standard requiring the court to accept allegations as sufficiently proven when it cannot reasonable consider the opposite anymore.[653]

E. Conclusion

174. The concise overview demonstrates that investors can submit claims for losses due to breaches of capital market law, even though differences were observed in terms of availability of private causes of action. In France and Belgium for instance, open civil liability rules were found, to apply in case legitimate interests have been violated. In the UK, Germany and the Netherlands on the other hand, relatively more restricted systems were observed as only protected rights intended to provide protection to claimants can be invoked. As a result, not every violation of capital market law is automatically actionable.[654] Once a claim can be filed, all legal systems require claimants to present evidence or facts supporting their claim, and particularly showing that a recoverable loss has been suffered as a result of the wrongdoing. Both requirements are to be interpreted and applied by the judiciary, which has broad powers to do so mostly because the assessment of causation and harm is highly factual. With regard to causation, it was furthermore observed that even though various doctrines and dogmatic theories may have developed over time, a highly similar approach was used in terms of assessing the factual causal relation between the violation and the emergence of the claimed loss, and secondly, corrections added in the light of normative considerations such as reasonableness, fairness, remoteness, foreseeability, adequacy, etc. It was also shown that in case the burden of proof imposed on the claimant to support his claim sufficiently turns out an obstacle, courts may alleviate

[650] See extensively G. ENGELS, *Der Anscheinsbeweis der Kausalität*, Frankfurt am Main, Lang, 1993, 57 ff.; ROSENBERG, SCHWAB and GOTTWALD (eds.), *Zivilprozessrecht*, §108, para. 16, and more extensively: §112, para. 16 ff.

[651] See with regard to the employment of the concept '*Anscheinsbeweis'*: PALANDT (ed.), *Bürgerliches Gesetzbuch*, §123 BGB, para. 24; vor §249 BGB, para. 163; §823 BGB, para. 80; see also: WEBER, *Der kausalitätsbeweis im Zivilprozess*, 181.

[652] §287 ZPO ('*Zivilprozeßordnung*'). See for instance: ROSENBERG, SCHWAB and GOTTWALD (eds.), *Zivilprozessrecht*, §113, para. 2 ff.; A. BAUMBACH, J. ALBERS and P. HARTMANN (eds.), *Zivilprozessordnung*, München, Beck, 2005, §287, para. 6 ff.; GEIBEL, *Der Kapitalanlegerschaden*, 165; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 89; M. BARTH, *Schadensberechnung bei Haftung wegen fehlerhafter Kapitalmarktinformation*, Frankfurt am Main, Lang, 2006, 150.

[653] Idem.

[654] See for instance §20a WpHG, which contains a prohibition to carry out market abusive practices. This prohibition aims to protect market integrity and the price formation process on financial markets, but does not provide individual investors with a cause of action to claim damages for losses suffered as a result of market manipulation. Similarly, in the UK, ss.118, 123 and 383 FSMA that contain rules and a general prohibition to carry out market abuse do not give rise to an actionable civil liability claim in court. Consult in this regard: *Hall v. Cable and Wireless Plc*, (2009) EWHC 1973 (Comm.), at para. 23. See also in the previous chapter, para. 100 and ftn. 373.

evidential problems by means of presumptions or other relaxations. Some examples of judicial interventions in this regard are available, yet in some cases, legislators have stepped in to remedy difficulties investors encountered in obtaining compensation following breaches of capital market law based on general liability rules. As a result, more specific and tailed statutory causes of action have been promulgated and may offer (more) serviceable alternatives for wronged investors as these rules have often been enacted to facilitate investor suits and resolve difficulties in this regard.

III. Remedies following specific statutory liability regimes

A. Introduction: the emergence of (national) capital market liability law?

175. The preceding chapter highlighted that the direct impact of EU capital market legislation on national private liability laws has been relatively modest. As a result, investors allegedly aggrieved following violations of (EU originated) capital market law have turned to national courts to seek relief based on national general civil liability law. National courts were assigned with the task of interpreting and applying the general principles and rules set out in the preceding section to find answers to specific questions and problems that arose in the context of investor litigation. Over time, specific approaches, principles or solutions adjusted to questions or problems that recurrently came up in investor litigation have been developed and gradually refined by courts.[655] Yet in other cases, national legislators stepped in to resolve particular questions or difficulties and enacted statutory rules to modify and adjust general liability rules, sometimes anchoring the approaches and concepts that had been developed by courts (i.e. the German concept of '*Anlagestimmung'*), or otherwise simply enacting new rules. In some instances, the enactment of statutory liability rules has gone as far as designing a tailored liability regime applicable to particular violations of capital market law and governing a wide range of aspects, such as the standard of fault, the burden of proof, and the remedy or measure of damages. A concise overview of the statutory liability rules enacted specifically with regard to violations of capital market law is presented below.

B. Issuer disclosure obligations: statutory rules

1. Prospectus liability

176. In some cases, the enactment of specific statutory liability rules has been considered necessary in the light of newly enacted European capital market legislation, yet in other instances, the transposition of EU regulation offered an opportunity to reform and to modify the existent legal framework, often with an aim to enhance the position of aggrieved investors.[656] Yet in some jurisdictions, such as the UK and Germany, statutory regimes governing prospectus liability were first enacted irrespective of European obligations and long before the Prospectus Directive came along.[657]

[655] Notable examples can be found in the German case law for instance, including the concept of '*Anlagestimmung'* and '*Kursdifferenzschaden'*. These concepts are explained and elaborated on further below.

[656] The reforms were often considered against the background of raised concerns regarding the difficulties investors encounter in obtaining redress for losses (allegedly) suffered as a result of breaches of financial law. With regard to Belgium, see for instance: *Parl. St.*, Kamer 2005-2006, Doc 51, nr. 2344/001, 2345/001, p. 74. The implementation of the Prospectus Directive also triggered reforms in Spain as well, including the enactment of specific statutory prospectus liability rules. see in this regard: SEBASTIÁN and TORTUERO, 'Prospectus liability under the Spanish Securities Market Act: a comparison between the New Spanish Regime and the US regime', 331.

[657] In the UK for instance, prospectus liability was originally developed in the case law under the torts of deceit and negligent misrepresentation. Finding that common law did not adequately protected investors subscribing to public securities offers

Notwithstanding the existence of these specific statutory regimes, the statutory regimes usually do not entirely replace the tort systems as investors can still file their claim under general civil liability law in most Member States.[658] Moreover, as the statutory regimes often regulated certain but not all aspects of prospectus liability claims, general civil liability law is necessary to fill in the gaps. Secondly, as the circle of elicit defendants that can be sued under the statutory regimes is generally limited, the general civil liability rules may still be convenient or even necessary as a legal basis to file claims against other parties allegedly responsible for the harm. A concise overview aiming to outline the essence of these statutory regimes is presented in the next paragraphs[659], yet the question whether and to what extent these statutory rules impact the analysis of causation and loss is examined in more detail in the next chapters.

177. Degree of fault required. – Taking the various statutory regimes enacted in Germany (§§21-25 WpPG)[660], Belgium[661] and the UK (s.90 FSMA) into account, various differences can be noted with regard to the required degree of fault, evidential and procedural rules, the circle of elicit defendants, etc. According German law for instance, the standard of fault is set at gross negligence (*'großer Fahrlässigkeit'*) or intent (*'Vorsätzlichkeit'*) it concerns incomplete or incorrect prospectus information, while mere negligence suffices to impose liability on defendants in case of a failure to publish a prospectus.[662] According to the UK rules, the standard for liability is negligence, while the burden of proof is partially shifted to the defendant who is required to prove that he did not act

however, a statutory cause of action was enacted as early as 1890 by the Directors' Liability Act and the Misrepresentation Act in 1967. For an overview: HUDSON, *Securities Law*, 583, para. 23-25 ff.; A. ALCOCK, 'Liability for misinforming the market', *JBL* 2011, 243-246; VEIL and WUNDENBERG, *Englisches Kapitalmarktrecht*, 19; P.C. LEYENS and U. MAGNUS, 'England', K.J. HOPT and H.C. VOIGT, *Prospekt und Kapitalmarktinformationshaftung*, Tübingen, Mohr Siebeck, 2005, 428, 431; BOURNE, *Bourne on Company law*, 69; A. ALCOCK, 'The rise and fall of UK quoted company regulation', *JBL*, 2007, 733-758; AVGOULEAS, *Mechanics and Regulation of Market Abuse*, 414. With regard for Germany, a concise overview is available in: A. HELLGARDT, 'Prospectus Liability', J. BASEDOW, K.J. HOPT and R. ZIMMERMANN, *The Max Planck Encyclopedia of European Private Law*, Vol. II, Oxford, Oxford University Press, 2012, 1384.

[658] With regard to Germany for instance, an express reference has been provided to this end in §25(2) WpPG. UK: HUDSON, *Securities Law*, 23-03.

[659] For an extensive overview in this regard, consult: ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619, Annex II (comprising a comparative table of responses received from the EEA states) and Annex III (showing the individual responses to the questions asked on the prospectus liability rules).

[660] The German prospectus liability regime has been laid down in §§21-25 WpPG ('*Wertpapierprospektgesetz'* or Securities Prospectus Act). Until recently, the regulation was laid down in §44-§48 of the Act on the Drawing up, Approval and Publication of the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading on an Organized Market (Securities Prospectus Act), enacted in 2005 to implement the EU prospectus Directive and amended in 2012. See in this regard: Gesetz zur Novellierung des Finanzanlagenvermittler- und Vermögensanlagenrechts vom 6 December 2011, BGBl. I s. 2481.The amendments came into force on June 1st, 2012. See on the changes, including the implementation of the amended EU Prospectus Directive (2010): HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, 735, para. 6 ff. The Securities Prospectus Act applies to public offerings of securities as defined in the act, which does not include investment products as defined and regulated in the Capital Investment Act ('*Vermögensanlagengesetz'* or '*VermAnlG*''). These investment products are described by the German supervisor (BaFin) as securities which either grant the investor participation in a company's profits, or which grant participation in assets held or managed by the issuer or a third-party on its own behalf for the account of a third party (trust assets), or for units in other closed-end funds that are offered to the public in Germany, or which grant participation rights ('*Genussrechte*') or which constitute registered bonds ('*Namensschuldverschreibungen'*). See in this regard: BaFin, Investment Prospectuses 5 July 2012, available at: http://www.bafin.de. The prospectus rules governing violations against these rules are laid down in §§20-22 VermAnlG and discussed in detail, including a comparison with §§21 ff. WpPG, in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 59 ff.

[661] Law of 16 June 2006 on the public offering of financial instruments and admission to a regulated market, *BS* 21 June 2006 ('Prospectus Act').

[662] According to §23 WpPG, defendants are not liable when they can present evidence that they were unaware of incorrect or incomplete information contained in the prospectus, insofar their unawareness is not the result of gross negligence or intent. See also: HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 38.

negligently.[663] As the provisions in the Belgian Prospectus Act do not contain express rules on the standard of fault, it is assumed that the standard of fault is negligence, in accordance with art. 1382 BCC.[664]

178. Potential defendants. – The German rules further state that liability for erroneous or incomplete prospectus information is imposed on those who assumed responsibility for the contents and composition of the prospectus (i.e. by signing the prospectus) and those who are responsible for the prospectus.[665] The first category of defendants consists of those who sign the prospectus including the issuer who is required to sign according to §5(3) WpPG.[666] In addition to those who signed the prospectus, persons who have economic interests in the issuance (other than the compensation for the professional activities related to the issuance), such as (members of) the board of directors, principal shareholders etc may be held liable too.[667] The defendant bears the burden of proof to demonstrate the correctness of the prospectus information and, in case he fails to do so, the lack of intent or recklessness with which the fault was committed.

According to the Belgian statutory rules, the prospectus must indicate which of the aforementioned persons assumed responsibility and may thus be held liable for misleading information.[668] Only the issuer, its administrative or supervisory bodies (including the board of directors), the offeror and the person asking admission to trade on a regulated market can be named as responsible persons for the prospectus and the information it contains, and must declare its truthfulness and accurateness. According to UK law, investors can sue any of the persons responsible for the prospectus or listing particulars as listed in s.90 FSMA.[669] Furthermore, only claims pursuant to transactions, i.e. the

[663] Schedule 10 FSMA. According to the statutory provisions, both the issuer and the directors are required to assume responsibility for prospectuses relating to equity (share) prospectuses, whereas in the context of other types of securities issued, only the issuers can be held responsible (Prospectus Rules 5.5.3 (1) and (2)).

[664] See in this regard: ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619, Annex II, Question 5 (answers on the Belgian regime have been answered by the Belgian Financial Services and Markets Authority). See also: RAVELINGIEN, Privaatrechtelijke handhaving, 414, para. 799. See on this topic also: C. BOLLE, 'Belgium', K.J. HOPT and H.C. VOIGT, *Prospekt und Kapitalmarktinformationshaftung*, Tübingen, Mohr Siebeck, 2005, 350-354; M. FYON, 'Quelques réflexions sur l'évolution de la responsabilité quasi-délictuelle en matière de prospectus', C. BRUYNEEL, J. BUYLE, M. DELIERNEUX, J. ROMAIN and E. VAN DEN HAUTE, *Synthèses de droit bancaire et financier. Liber Amicorum André Bruyneel*, Brussel, Bruylant, 2008, 417-418.

[665] §21(1) WpPG. Extensively: ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 218 ff.; M. HABERSACK, P.O MÜLBERT and M. SCHLITT, *Handbuch der Kapitalmarktinformation*, München, Beck, 2008, §28, para. 10 ff.; SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, §44-§45; W. GROSS, *Kapitalmarktrecht*, Munich, Beck, 2009, §44; HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 13 ff.

[666] Extensively: HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 26.

[667] ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619, Annex III, 87. It is discussed however when auditors can be liable for erroneous information in a prospectus. There is consensus that auditors are liable in this context if they took responsibility for the whole prospectus, but whether they can also be liable when they only provided a part of the whole prospectus or provided the information needed of a certain part of the prospectus is unclear. See for those authors arguing against liability based on §44 BörsG in the latter case: HELLGARDT, *Kapitalmarktdeliktsrecht*, 300 and references cited; ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 224 ff. *But*: GROSS, *Kapitalmarktrecht*, §44,45 BörsG, para. 37. See on this topic also: HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 79; and SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, §§ 44-45 BörsG, para. 12.

[668] Art. 6(1) Prospectus Act.

[669] The list includes the issuer of the shares, every director of the issuer unless the prospectus was published without the knowledge or consent of the director, every person named in the document as director or as having agreed to be one, insofar the person in question authorized this, everyone else accepting responsibility for the prospectus and stated as such in the prospectus, and everyone who authorized the contents. Principal advisers of the issuing company might be within the range of potential defendants as well, as s.90 FSMA also includes any person who is stated in the prospectus as taking up responsibility for any part of it or who has authorized its contents. The liability of professional advisers with regard to prospectuses is not evident however. Insofar they were not involved in the authorization of (parts of) the prospectus, it is generally considered that no liability than arise for the advice they provide. See on this in detail: HUDSON, *Securities Law*, 548, 21-37 ff.; S. GIRVIN S. FRISBY & A. HUDSON, *Charlesworth's Company Law*, London, Sweet & Maxwell, 2010, 272, 14-

purchase or sale of securities, are eligible. Claims filed for abstaining from trading following wrongful prospectus information cannot lead to a claim under s.90 FSMA, while the German rules only consider the purchase of securities. The Belgian legislation does not contain express rules in this regard.

179. Requirement of causation and available remedy. – With regard to the requirement of causation, it is noted that all of these three regimes provide for evidential facilitations by means of a presumption of causation. According to the German rules, the causal nexus between the loss suffered by the claimants and the erroneous information is also presumed, though may be rebutted by if the defendants can demonstrate that the claimant did not acquire the securities on the basis of the prospectus information.[670] In case the defendants fail to rebut the allegations, the purchase of the instruments is rescinded and the parties are restored in the situation as if the sale never took place, implying that the acquisition is rescinded, the acquisition price paid back and the shares returned. In case the claimant has already sold the shares, damages are paid based on the difference between the purchase price and the price received upon the sale.[671]

180. The Belgian and UK prospectus liability regime also provide for causal presumptions.[672] According to s.90 FSMA, the investor is not required to prove that he relied on the wrongful information.[673] This implies that causation between the deficient disclosure and the investment decision made by the investor is in fact presumed. Schedule 10 furthermore clarifies that prospectus claims fail in case the defendant presents evidence that the claimant was aware of the misleading or untrue character of the misleading information, or knew relevant information was omitted.[674] Art. 61 of the Belgian prospectus act also provides for a rebuttable presumption of causation[675], yet the concept of recoverable loss and the assessment of the damages has been left to deal with under the general liability rules.[676]

181. Prospectus liability according to general liability rules: the French example. – It is also noted that in various Member States no specific legislative measures have been enacted, such as France. As a result, prospectus claims brought under French law are dealt with under the general civil liability rules. Depending on the relation between the parties, the claim is contractual or non-contractual in nature. Contractual claims require a contractual relation between the parties, for instance in case sponsoring banks function as an intermediary for the issuer, concluding the securities purchase on behalf of the issuer, or if the client directly purchases from the underwriter. If a contractual claim is brought, the rescission based on error ('*erreur*') or fraud ('*dol*') can be claimed. Yet most claims are

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017. See also s.90 FSMA and Prospectus Rules para 5.5.9R. stating that professional advisers are not targeted by the prospectus regulation.

[670] §21and §23 WpPG.

[671] See also: WAGNER, 'Schadensberechnung', 497; ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 218 ff.; MAIER-REIMER/PASCHOS in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §28, para. 10 ff.; SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, 414, §44-§45; GROSS, *Kapitalmarktrecht*, §44; HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 13 ff.

[672] Belgium:

[673] ALCOCK, 'Misinforming the market', 246; HUDSON, *Securities Law*, 578, 23-15, 23-16. VEIL and WUNDENBERG, *Englisches Kapitalmarktrecht*, 28.

[674] Para. 6, Schedule 10. See also: ALCOCK, 'Misinforming the market', 246; HUDSON, *Securities Law*, 578, 23-15, 23-16. This seems to confirm that reliance is presumed under s.90 FSMA. See also: DAVIES, 'Davies review. Discussion paper', para. 27 and 55.

[675] Art. 61, §2 and §4 Belgian Prospectus Act. See also: VANDENDRIESSCHE, 'Fraud-on-the-market', 338, para. 79 ff.

[676] HUDSON, *Securities Law*, 23-23; ALCOCK, 'Misinforming the market', 251. The measure of damages is elaborated in the following chapters.

based on the non-contractual provisions laid down in art. 1382-83 FCC. The general liability rules do not contain limitations as to who can be sued[677], nor are evidential rules facilitated or relaxed as is often the case with regard to statutory prospectus liability rules. As discussed in the following chapters however, courts have facilitated investor claims by applying the theory of the loss of chance (‘*perte de la chance*’).[678]

182. The Dutch prospectus liability regime. – In the Netherlands, investor claims for deficient prospectuses can be brought based on the general tort law provision of art. 6:162 DCC (*lex generalis*), or alternatively, investors can also invoke the statutory rules governing misleading advertisements and unfair commercial practices (*lex specialis*), since erroneous prospectus information is also qualified as misleading advertisement.[679] The rules regarding misleading advertisements (6:194-195 DCC) apply to professionals exploiting a business or other professional activities in investments, whereas the unfair commercial practices regulation (art. 193a-6:193j DCC) exclusively applies to ‘consumers’, which includes retail investors.[680] Both these sets of rules offer (similar) procedural and substantive facilitations to the claimant using them. Both regulations specify what the concept ‘misleading’ implies.[681] Art. 6:193c-d DCC explicitly includes both omissions and the spreading of incomplete or incorrect information[682], art. 6:194 DCC on the other hand was found by the Dutch Supreme Court to imply incomplete information.[683] The main facilitation offered by these statutory rules, however, is the double reversal of the burden of proof with regard to the misleading nature of the information and the culpability of the issuer laid down in art. 6:193j and art. 6:195 DCC. It is left to the *defendant* to prove the prospectus is complete and correct when a claimant claims damages consequent to a misleading prospectus based on these sets of rules. If the defendant fails provide such evidence, he will be deemed liable for the losses caused by the erroneous information.[684] Causation, damages and measurement of the damages have not been expressly regulated in the statutory provisions. These elements are to be considered in accordance under the general non-contractual liability rules (art. 6:162, art. 6:98 DCC).

[677] The French courts upheld the rule that board members could not be sued by third parties, including shareholders. Only to the extent the behavior is incompatible with the normal execution of his duties, a director could be held liable by third parties. as a result of statutory intervention and an evolution in the courts however, the limitations concerning board members are no longer applied. See for instance: Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (SA EPF Partners/A.), *JCP-E, 2010*, n° 20, Mai, 1483, with ann. by S. SCHILLER. See for an extensive discussion: ARONS, *Cross-border Enforcement*, 108-114.

[678] See the following chapters for a more detailed discussion.

[679] Art. 6:194-6:195 DCC on misleading advertisement; art. 6:193a-6:193j DCC. Art. 6:193a DCC on unfair commercial practices. See also: ARONS and PIJLS, ‘Prospectus liability in the Netherlands', 452-485; M.H.C. SINNINGHE DAMSTÉ, 'Dwaling als alternatief bij prospectusaansprakelijkheid', 18 *O&F*, 2010, nr. 3 72-85. The rules on unfair commercial practices and misleading advertisement are implementations of European directives: Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Directives 84/450/EEC, 97/7/EC, 98/27/EC and 2002/65/EC and Regulation (EC) No 2006/2004, 2005, *OJ* L 149, 22-39; and: Council Directive 84/450/EEC of 10 Sept. 1984 relating to the approximation of the laws, regulations and administrative provisions of the Member States concerning misleading advertising, (1984), *OJ* L 250, 17-20.

[680] The concept ‘consumers’ in this context is defined in 6:193a DCC. See in this regard also: DE JONG, *Schade door misleiding*, 63 ff.; ARONS and PIJLS, ‘Prospectus liability in the Netherlands', 452; ARONS, *Cross-border Enforcement*, 56.

[681] See for more extensive discussion: ARONS and PIJLS, ‘Prospectus liability in the Netherlands', 464-471; and: DE JONG, *Schade door misleiding*, 18 ff.; ARONS, *Cross-border Enforcement*, 56 ff.

[682] Art. 193g-i DCC contain enumerated lists of unfair commercial practices. For a detailed oversight of the regime, consult: ARONS and PIJLS, ‘Prospectus liability in the Netherlands', 452-454, 459.

[683] HR 8 May 1998 (*Boterenbrood/MeesPierson NV*), *NJ* 1998, 888, with ann. by J.M.M. MAEIJER and D.W.F. VERKADE.

[684] Unless evidence is provided that the defendant is not responsible for the information (art. 6:193j; art. 6:195 DCC). For an extensive discussion: ARONS and PIJLS, ‘Prospectus liability in the Netherlands', 461.

Note however that the Dutch Supreme Court introduced a presumption of causation in the field of prospectus liability law.[685]

183. Liability for prospectus information in the context of UCITS. – As discussed in the first chapter of this part, prospectuses are a prerequisite to public securities offerings by issuers, but also in case UCITS of the open ended type offer investments to the public.[686] As a result, some jurisdictions have enacted specific legislative provisions that deal with liability for this kind of prospectuses too. For instance, in Belgium and Germany, liability rules similar to those applicable to issuer prospectus have been enacted, stating that the persons responsible for the prospectus must be indicated in the prospectus, while the offeror, the undertaking for collective investment and the management company are automatically considered responsible. In line with art. 61 of the Belgian Prospectus Act and §§21-23 WpPG, causation between misleading or incomplete information and the loss suffered is presumed. The assessment of the loss is to be assessed according to principles of general liability law pursuant to Belgian law, whereas the German provisions hold that the acquisition of the instruments is rescinded, which implies the return of the instruments in return for the price paid or in case the investor no longer holds the units, damages covering for the difference between the issue price and the redemption price may be demanded.

184. Conclusion. – The national prospectus liability regimes share similarities, such as a limited number of potential defendants, a specified standard of liability, facilitations with regard to the requirement of causation and the evidential rules. Besides these similarities, various differences are observed too, such as the required degree of fault, ranging from strict liability over gross negligence to mere negligence[687], procedural and evidential rules[688], the kind of transactions executed (or not executed) that entitles an investor to sue for damages[689] and the circle of defendants against whom the claims are directed, may differ depending on which national prospectus law applies.[690] Furthermore, whereas some jurisdictions enacted specific prospectus liability regimes covering various aspects of prospectus liability claims and often intended to facilitate investor claims with tailored rules, others resort to their general liability laws. A similar tendency can be observed with regard to the liability rules applicable to claims filed for deficient secondary market information.

[685] HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht*, 2010, 21, with ann. by H.M. VLETTER-VAN DORT. See in one of the next chapters for a more extensive discussion.

[686] Belgium: Art. 63 Law of 3 August 2012 on certain forms of collective investment portfolio management ("Wet betreffende bepaalde vormen van collectief beheer van beleggingsportefeuilles"), *BS* 19 October 2012. Germany: §127 Investmentgesetz (Investment Act) of 15 December 2003, BGBl. I S. 2676 (InvG). See also: ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 288; for an overview, see also: HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 67 ff.; A. WÜSTHOFF and B. KLÄSENER, 'Germany', D. VAN GERVEN *Prospectus for the public offering of securities in Europe'*, Vol. II, New York, Cambridge University Press, 2009, (88) 98, para. 6.23. More general: WAGNER, 'Schadensberechnung', 498; See for more extensive comments: HELLGARDT, *Kapitalmarktdeliktsrecht*, 13 ff.; EHRICKE, 'Deutschland', 234 ff.; see also: S. KRUG, *'Anlegerschutz bei der Emission von Schuldverschreibungen'*, Hamburg, Kovač, 2010, 71 ff.

[687] ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619, Annex II, question 5.

[688] Germany, Belgium, the UK and the Netherlands provide for presumptions of causation while the French law does not.

[689] S.90 FSMA requires that a transaction occurred, i.e. a sale or a purchase, yet the mere decision to retain or to refrain from trading does not give rise to an eligible claim. Under the French, Belgian or Dutch law, no such limitations seem to apply.

[690] For an extensive overview: ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619, Annex II and Annex III.

2. Secondary market disclosure obligations: Member States' liability regimes

185. Overview. – Secondary market disclosures encompass the periodic financial reporting obligations enacted by the Transparency Directive (i.e. annual and half-yearly financial reports) and the continuous ad hoc disclosure obligations imposed by the Market Abuse Directive, yet it may also include press releases or other statements that have been made (on a voluntary basis) to the market by the issuer or its staff, including oral communication. As pointed out in the previous chapter, the Transparency Directive requires the Member States to apply their national liability rules in case the periodic financial reporting obligations are not complied with, whilst the Market Abuse Directive is completely silent on the application of liability rules for violations of the ad hoc disclosure rules. Compared to the area of prospectus liability, violations of continuous disclosure obligations are considerably less governed by specific, tailored liability regimes. For example, in Belgium, the Netherlands and France no specific liability rules have been enacted, instead the general non-contractual liability laws apply. Germany and the UK on the contrary have enacted statutory rules governing certain – yet not all – aspects with regard to liability claims following breaches.

186. UK: s.90 FSMA. – In response to the enactment of the Transparency Directive, the UK[691] introduced statutory liability rules governing violations of continuous disclosure obligations.[692] Although formally compliant with the requirements set by EU regulation, the newly enacted s.90A FSMA was immediately criticized for its restrictive scope[693], causing a substantial revision to be undertaken following which the scope of the s.90A FSMA was expanded. The current s.90A FSMA allows purchasers, sellers and holders of securities in reliance on fraudulent issuer disclosures to file claim for damages.[694] The rule applies to incorrect and incomplete periodic and ad hoc disclosures, 'dishonest concealment' of information and non-financial information disclosed to the market. The standard of fault is fraudulent intent or recklessness, while claimants are also required to present proof of their reliance on the misstatements.[695] Since no provisions have been enacted with regard to the concept of recoverable loss and damages assessment, the general tort measure of damages applies. S.90A FSMA also provides in an exclusion of liability for misstatements in case claims can be brought based on s.90 FSMA, liability for breach of contract, liability under the Misrepresentation Act and criminal liability in general.

[691] It should be noted that in this context reference can again be made to the Misrepresentation Act, which offers facilitations to claimants who suffered losses as a result of a material misrepresentation. The Misrepresentation Act though seems not very relevant in the context of secondary market information as it only covers for misrepresentations that resulted in the conclusion of a contract. This will generally not be the case in the context of ad hoc disclosure and periodic reporting, leaving an allegedly wronged investor with s.90A FSMA.

[692] S.90A FSMA only entered into force as of October 1st, 2010. Doubts had been raised whether the then existing rules could be considered sufficient to meet the requirement laid down in art. 7 Transparency Directive. Explanatory Memorandum to Financial Services and Markets Act 2000 (liability of issuers) Regulations 2010, available at: http://www.legislation.gov.uk/uksi/2010/1192/memorandum/contents, para. 4.1.

[693] The statutory regime provided for in s.90A FSMA originally only covered periodic reporting and excluded claims for deficient ad hoc disclosures from its scope. Only the issuer could be sued and by purchasers only (excluding sellers in other words). Furthermore, proof was required showing that the misleading or untrue information was known to be untrue or misleading by any director, or that the latter acted recklessly as to the correctness of the statement in order to hold directors responsible. The latter liability standard is clearly inspired on the tort of deceit and is known to be a barrier for liability claims. A claimant also needed to present proof of his reliance on the information, and the fact that it is was reasonable to do so. See also: ALCOCK, 'Misinforming the market', 248; DAVIES, 'Davies review. Discussion paper', para. 40 ff.

[694] Note that contrary to Germany, s.90A FSMA allows holders of securities to claim. In Germany, the legislator made a deliberate choice to require a transaction (sale or purchase) in reliance on the deficient information in order to file a claim under §37 b, c WpHG, which excludes holders of securities from its scope.

[695] Besides the fact that there was reliance on the misstatement, it should also be the case that it was reasonable for the claimant to rely on the information.

187. Germany. The dichotomy between ad hoc and periodic disclosure. – Contrary to UK law, the German legal system provides for a separate set of statutory (liability) rules applicable to ad hoc disclosure, while no specific statutory regime has been enacted with regard to periodic financial reporting rules. The rules applicable to ad hoc disclosures were enacted in 2002 in the aftermath of a series of financial scandals and can be found in §§37b and c of the German Securities Trading Act ('*Wertpapierhandelsgesetz'* or 'WpHG').[696] Claims based on §§37b and c WpHG can only be filed against the issuer following the purchase of sale of securities to which the misleading, omitted or untimely disclosed information relates.[697] The degree of fault has been set at intent or gross negligence, yet evidential burden has been shifted as it is left to the defendant to present evidence that he has not acted intentionally or grossly negligent. With regard to the requirements of causation and the recoverable loss, §§37b, c WpHG do not provide for express modifications or adjustments, yet the German Supreme Court has ruled that the traditional concept of loss and causation can be applied under §§37b, c WpHG, whilst an alternative approach (i.e. '*Kursdifferenzschaden*') may be applied too.[698] The implications and conceptual approach to the recoverable loss and the concept of causation in this context is elaborated in one of the following chapters.

It is emphasized however that the arrangement of §§37b, c WpHG only applies to ad hoc disclosure duties and that it is not extended to the periodic disclosure obligations such as the annual (§37v WpHG) and half-yearly (§37w WpHG) financial reports, nor to voluntary misstatements or other kinds of communication to the market. Instead, investors allegedly suffering losses following misleading or omitted periodic issuer disclosures remain dependent on national general liability law. In case intent can be established, claims can be based on §826 BGB, whilst it is generally accepted that claims can also be grounded on §823 II BGB in conjunction with §400 AktG or in conjunction with §331 HGB, which are both provisions prohibiting the disclosure of false information. Other legal bases, such as §823 II BGB in conjunction with §37v-z WpHG are debated on amongst scholars because the protective purpose of these vis-à-vis individual investors are uncertain.[699]

188. The fact that the German legislator has refrained from enacting a specific liability regime with regard to periodic liability rules, similar to the UK s.90 FSMA for instance, has generated criticism stating that Germany has failed to adequately implement the Transparency Directive into its legal

[696] Introduced via the German Fourth Financial Market Development Act ('*Viertes Finanzmarktförderungsgesetz'*). The duty to disclose ad hoc information is stated in §15 WpHG. The introduction of the statutory liability regime for ad hoc disclosure was triggered by a series of scandals involving companies listed on the German stock exchange 'Neuer Markt', which functioned as the technology index of Deutsche Börse. As it turned out that especially the companies listed on this market did not comply with the disclosure obligations contained in §15 WpHG and the latter provision was not recognized as a protective norm in the sense of §823 abs. 2 BGB (BVerfG, 24 September 2002, *ZIP* 2002, no. 44, 1986-1995, note by T.M. MÖLLERS and F.C. LEISCH), the German legislator decided to introduce a special, tailored statutory liability regime. Neuer Markt on the other hand was closed in 2003 after its reputation was tarnished by multiple scandals, such as ComROAD, EM.TV, Metabox and various other cases. See for instance: WAGNER, 'Schadensberechnung', 513; BAUMS, 'Haftung Falschinformation', 139-192; C. TEICHMANN, 'Haftung für fehlerhafte Informationen am Kapitalmarkt', *JuS* 2006, 955. By contrast, the statutory liability regime introduced in the UK was the consequence of the legislator's concern to comply with the EU Transparency Directive. See: DAVIES, 'Davies review. Discussion paper', para. 40 ff.; ALCOCK, 'Misinforming the market', 248.

[697] It should be clear however that with respect to liability following ad hoc misstatements or omissions, issuers are almost always the primary defendant.

[698] BGH, 13 December 2011, XI ZR 51/10, (IKB), *BB* 2012, 530 with ann. by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537-538.

[699] See for instance: HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 206, asserting that claims can be based on §823 II BGB in conjunction with §37v-z WpHG because the latter are to be considered protective provisions ('*Schutzgesetze'*). Similar: FUCHS and BOUCHON (eds.), *Wertpapierhandelsgesetz*, §37v WpHG, para. 32. *But:* HEIDELBACH/DOLECZIK in SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, §37v WpHG, para. 43, hold a different view.

order.[700] Some commentators have suggested to remedy the situation by applying §§37b, c WpHG analogously to periodic reporting obligations[701], yet according to the prevailing opinion this would run counter to the legislator's express intent with the enactment of §§37b, c WpHG and should therefore be rejected.[702] Secondly, it could also be argued that the dichotomous system providing for different liability regimes depending on whether it concerns an ad hoc or periodic disclosure adds to the complexity of the system without good reason. Incited by the different liability and litigation risks, issuers may try to disclose as much as possible through ad hoc disclosures instead of periodic information reports, while misstatements that disclosed in both forms may stir confusion as to which liability rules apply. Investors who purchased securities allegedly following misleading ad hoc disclosures may be favored over those who traded and suffered harm (allegedly) following misleading information in annual reports despite the fact that it may concern identical misstatements.[703]

189. Contrary to the UK and Germany, Belgium, the Netherlands and France have not enacted specific statutory rules enabling investors to claim damages pursuant deficient secondary market information. Instead, the general tort law regimes apply in these countries. In the Netherlands, the Supreme Court ruled that the information distributed outside the context of an initial public offering does not qualify as a misleading advertisement in the sense of art. 6:194 and 6:195 DCC. Neither do the unfair commercial practices apply since the information is not connected to the promotion, sale or supply of the securities on offer.[704] As a result, investors are required to bring claims based on the general tort rule laid down in art. 6:162 DCC.[705] Similarly, in Belgium and France as well, the general tort regimes (respectively art. 1382-1383 BCC and FCC) apply.

C. Intermediaries

190. Investment firms. – The private law effect of MiFID has been discussed in the previous chapter, concluding that regardless of whether the supervisory rules of conduct contained in MiFID require the Member States to provide for private causes of action, most Member States do provide for liability rules applicable to violations of information obligations or the distribution of unsuitable products to retail investors, although via concepts such as the duty of care, good faith etc.[706] These liability rules are mostly found in the Member States' general liability laws, provided for UK law where the conduct of business rules are privately enforceable via a specific statutory provision laid down in s.138D FSMA.[707] S.138D FSMA more particularly states that contraventions of a rule by an authorized person are actionable at the suit of a private person who suffers loss as a result. The term 'private person' includes any person who is not an individual (including incorporated entities)

[700] VEIL (ed.), *European capital markets law*, 266, para. 67; T.M.J. MÖLLERS, 'Investor protection in the system of capital markets law: legal foundations and outlook', 36 *N.C. J. Int'l L. & Com. Reg.*, 2010, 76-77.

[701] P.O MÜLBERT and S. STEUP, 'Emittentenhaftung für fehlerhafte Kapitalmarktinformation am Beispiel der fehlerhaften Regelpublizität', *WM* 2005, heft 35, 1633.

[702] MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §37b, c WpHG, para. 71; HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 9, para. 11 in particular.

[703] DAVIES, 'Davies review. Discussion paper', para 22.

[704] ARONS and PIJLS, 'Prospectus liability in the Netherlands', 458. Instead, secondary market information is disclosed to allow the investors and the market to remain informed with regard to efficient price setting (HR 7 November 1997, *NJ* 1998, 268 with ann. by J.M.M. Maeijer).

[705] See for instance also: I.J.F. WIJNBERG, 'Ondernemingsrecht, No Limits?', *Ondernemingsrecht*, 2011, no. 24, 122.

[706] See *supra* para. 100.

[707] The former s.150 FSMA is currently contained in s.138D FSMA following the amendments made by the Financial Services Act 2012, available at www.legislation.gov.uk. See for instance: *Zaki v. Crédit Suisse*, (2011), EWHC 2422 (Comm); Spreadex v. Sekhon (2008) EWHC 1136 (Ch). See also: MCMEEL and VIRGO, *Financial advice*, 196 ff.

unless the loss in question is suffered "in the course of carrying on business of any kind".[708] S.138D FSMA is not the only option available to aggrieved investors however, since claims can also be filed according to s.2(1) Misrepresentation Act, provided that the investor has been induced to enter into a contractual agreement because of misrepresentations.[709] The UK stands out with these statutory arrangements as most Member States resort to their general liability laws (mostly (pre)contractual liability law) for claims filed for violations of investor protection measures imposed on investment firms in the area of financial product distribution.[710] It should be noted however that even though the general liability law applies in Belgium as well, claims filed for violation of the MiFID rules of conduct have been facilitated by the enactment of a presumption of causation between the violation and the harm suffered.[711]

191. Credit rating agencies. – Following the obligations enacted in art. 35a CRA Regulation, Member States are required to provide for liability rules that allow for issuers or investors to hold credit rating agencies liable for grossly negligent or intentional infringements specified in the third annex to the Regulation that affected the credit rating on which the issuer or investor relied to invest, hold onto or divest from financial instruments covered by the rating. The rule is rather remarkable as it not only requires Member States to provide for civil liability in case of breach, but also formulates the outlines of the regime by requiring that the claimant relied on the rating and stating that the rule should apply to cases in which securities have been purchased of sold, but also to cases in which the securities have not been sold because of the breach. The European legislative initiative to include liability rules has incited some of the Member States to enact specific legislative provisions, yet even though the European legislation aimed to harmonize the rules according to which credit rating agencies can be held liable, it seems that there is still considerable room for difference.

Considering the newly enacted regulation in the UK for instance, designed to comply with art. 35a CRA Regulation.[712] In line with art. 35a (4) CRA Regulation, the UK rules clarify the concept of gross negligence, stating that gross negligence means that the senior management of the credit rating agency has been reckless as to whether an infringement occurred, whilst reckless is interpreted as acting 'without caring whether an infringement occurs'.[713] Other requirements, such as intent, reasonable reliance, due care, etc. are also specified in the legal provisions, while a limitation on the liability credit rating agencies can incur is made possible insofar "reasonable and proportionate" in the

[708] The regulations promulgated under the FSMA define private person as follows (art. 3 (1) Rights of Action Regulations: In these Regulations, "private person" means (a) any individual, unless he suffers the loss in question in the course of carrying on (i) any regulated activity; or (ii) any activity which would be a regulated activity apart from any exclusion made by article 72 of the Regulated Activities Order (overseas persons); and (b) any person who is not an individual, unless he suffers the loss in question in the course of carrying on business of any kind; but does not include a government, a local authority (in the United Kingdom or elsewhere) or an international organization." See for instance: Titan Steel Wheels Limited v The Royal Bank of Scotland PLC (2010) EWHC 211 (comm). See also: SPANGLER (ed.), *Investment Management*, 322, para. 6.158.

[709] The Misrepresentation Act has been discussed in one of the preceding sections of this chapter. See in this regard para. 133.

[710] This is the case in Belgium, France, the Netherlands, Italy and Germany for example (see also: *supra* para. 100).

[711] Art. 30ter Law on Financial Supervision. This arrangement is discussed in the next chapter.

[712] The Credit Rating Agencies (Civil Liability) Regulations 2013, available at: http://www.legislation.gov.uk/ (UK CRA Liability Regulations 2013). The rules entered into force on 25th July 2013. Again, the restrictive interpretation of the existence of a duty of care in the tort of negligence might have been too much of an obstacle to consider this really a cause of action according to which third parties would be able to obtain redress for breaches of the CRA Regulation, causing the UK to enact a separate set of rules meeting the requirements of art. 35a CRA Regulation. See also: EDWARDS, 'CRA 3 and the liability of rating agencies', 186.

[713] Regulation 4, UK CRA Liability Regulations 2013.

circumstances of the case.[714] According to the French legislative provisions on the liability of credit rating agencies on the other hand, which were introduced before the enactment of art. 35a CRA Regulation, clauses that aim to exclude liability are considered unlawful and void.[715] Contrary to its UK equivalent, the French legislator also refrained from interpreting the conditions upon which credit rating agencies can be held liable. Instead, L. 544-5 of the Monetary and Financial Code states that credit rating agencies that fail to comply with the obligations set out in the European CRA Regulation will be held liable for the harmful consequences of their wrongdoing according to the French tort and precontractual liability laws. According to French and UK law, causation, loss and damages is to be assessed according to the principles of general liability law.[716] Various other Member States have not (yet) enacted specific legislative provisions, leaving the matter to be dealt with under their general liability laws. Overall however, there is not much experience with cases filed against credit rating agencies and even less with such cases won by issuers or investors so far.[717]

IV. Conclusion: investor suits in the national legal frameworks

192. This chapter aimed to present a concise overview of the national legal frameworks on which investors can rely to claim damages for violations of (often EU originated) capital market law. As became clear throughout the text, the result resembles a mosaic of private causes of action when comparing the Member States liability laws, but also within Member States liability laws a patchwork of private rights of action has formed. The introduction of EU capital market law directives has generated different statutory liability regimes applicable to a specific kind of violations (e.g. misleading prospectuses, breaches of the MiFID rules of conduct, violations of ongoing reporting obligations) whereas in other instances the general liability laws have remained in place to govern the private enforcement of violations of capital market law. Furthermore, the enacted regimes are often are limited in scope, governing some aspects or conditions according to which liability is imposed, yet other aspects – notably the concept of recoverable loss and the assessment of damages – remain subject to the Member States' general liability laws. Even in those cases where (minimal) attempts to harmonize the Member States' liability laws were initiated, with as most prominent example liability rules applicable to credit rating agencies for defined violations of the EU CRA Regulation, the differences between the liability regimes across the various Member States remain considerable.[718] As

[714] Regulation 9 UK CRA Liability Regulations 2013. Indications that a limitation on liability may be considered reasonable and proportionate in the circumstances of the case are also set out in the rules and depend on whether the claimant is an issuer or an investor, and whether the ratings were solicited or not by the issuer-claimant. See: Regulation 10-12 UK CRA Liability Regulations 2013.

[715] Art. L. 544-6 of the Monetary and Financial Code.

[716] The UK rules particularly state that the tort measure applicable in negligence applies with regard to the damages owed to investors in case no contractual relation exists, whilst issuers are entitled to the increase in the financing costs resulting from the affected credit rating. In case a contractual relation exists on the other hand, the damages are to be measured in accordance with the contract. Regulation 13 (issuers) and 14 (investors) UK CRA Liability Regulations 2013.

[717] For overviews with regard to CRA liability rules: B. HAAR, 'Civil Liability of Rating Agencies - Regulatory All-or-Nothing Approaches between Immunity and Over-Deterrence ', 2013, University of Oslo Faculty of Law Research Paper. Available at SSRN: ssrn.com/abstract=2196828, 20p. For a comparative overview with references to the German, Austrian, US and Italian legal system: A. SCARSO, 'The Liability of Credit Rating Agencies in a Comparative Perspective', 4 *JETL*, 2013, iss. 2, 163. With regard to the UK: EDWARDS, 'CRA 3 and the liability of rating agencies', 186. The Netherlands: J.J. ATEMA and S.M. PEEK, 'Credit rating agencies en civielrechtelijke aansprakelijkheid', D. BUSCH, C.M.J. KLAASSEN and T.M.C. ARONS, *Aansprakelijkheid in de financiële sector*, Deventer, Kluwer, 2013, 931.

[718] *Supra*, para. 191. With regard to MiFID, Moloney concludes along similar lines that the Member States' liability regimes are far from harmonized and deal with violations of MiFID-regulated matters in a different manner when it comes to private enforcement of those violations. MOLONEY, 'Liability of asset managers: a comment', 417 (the conclusion is drawn from the country reports discussing the private liability rules applicable to asset managers in various EU Member States, to be found in

a result, the requirements an investor-claimant is required to meet, the evidential rules applicable in a given case, and the remedy available to redress the injury depend on the cause of action that is being employed, shaping a rather fragmented picture of the Member States capital market liability laws.

193. With regard to the concepts of causation and loss as applied in the Member States general liability laws, a rather similar approach was observed. Causation is generally assessed by means of a factual causation test, complemented with normative criteria based on remoteness, foreseeability, and reasonability, aimed at providing courts with the tools to reach acceptable and fair decisions in each of the legal systems. As to the concept of recoverable loss, each Member State deploys a similar technique or approach consisting of a comparison of the actual situation in which wrongdoing occurred, with a hypothetical alternative scenario assuming the situation as it would be absent any wrongdoing. The negative difference between the two situations is considered the loss suffered by the investor. The details on how this technique plays out specifically in the context of investor losses for defective investment services and in case of deficient issuer disclosure are examined in the next two parts of this thesis.

BUSCH and DE MOTT (eds.), *Liability of asset managers*, 2012). See for a similar conclusion on the Member States' liability regimes applicable to violations of EU capital market law also: VEIL (ed.), *European capital markets law*, 476-477.

PART II. COMPENSATORY INVESTOR SUITS IN INVESTMENT SERVICES: CONCEPT AND ASSESSMENT OF CAUSATION AND LOSS

194. Financial service providers are expected to comply with their regulatory obligations on the one hand, and the general duty of care on the other. Consequent to the breach of one of these duties, aggrieved investors may be entitled to redress for the loss suffered as a result of the breach. The previous chapter demonstrated that causes of action are generally available to investors for defective investment services under the Member States' general liability laws, and/or under specific statutory causes of action as is for instance the case under UK law (s.138D FSMA and s. 2(1) Misrepresentation Act).[719] Assumed that a violation of the rules or duty of care is successfully established in court, the question arises to what extent aggrieved investors can obtain compensation for the losses allegedly suffered as a result of the breach. This second part of the thesis examines the concept of recoverable loss caused by violations effected by financial intermediaries in detail. The first chapter therefore discusses the requirement of transaction causation and the evidential problems associated with this requirement, while the second chapter discusses the requirements of loss causation and recoverable loss in more detail. As loss causation and the concept of recoverable loss are entwined to a considerable extent, there requirements are not discussed in separate chapters.

CHAPTER I. THE REQUIREMENT OF TRANSACTION CAUSATION IN INVESTOR SUITS FOR DEFECTIVE INVESTMENT SERVICES

I. Transaction causation in investor suits: the reliance model

195. It was explained in the previous chapters that precontractual information obligations in the context of investment services and the rules of conduct in general were designed to protect the perceived weaker party, i.e. the (retail) investor vis-à-vis the professional investment firm, and eliminate potential information asymmetries.[720] To the extent investment firms fail to provide clients with sufficient relevant information, suitable proposals for investments, or warnings as prescribed by law, clients may be unable to give their informed consent with regard to recommended or offered investment products, investment strategies or the execution of orders.[721] For example, assume a financial advisor who disregards his duty to draw up a client profile according to the 'know your customer'-obligation and subsequently fails to recommend a suitable investment strategy to the client, who ends up with a far more risky product or investment strategy than he would have been willing to take had he been duly informed or warned. Similarly, in case an asset manager adopts a highly offensive strategy whereas the client is a non-sophisticated, non-experienced retail investor looking for a conservative and relatively safe investment strategy, the investor will generally claim that in case a correct profile had been recorded, other investments would have been made with his savings. Another

[719] It is noted that the regulatory duties and the duty of care imposed on financial service providers are not discussed in more detail as it exceeds the subject of this dissertation. As it is assumed that a breach has occurred, the text concentrates on the requirements of causation and loss as well as the calculation of damages.

[720] See *supra*: para. 12.

[721] Similar: GEIBEL, *Der Kapitalanlegerschaden*, 13; WEBER, 'Anlägeschaden', 136.

frequently recurring situation in this context concerns cases in which the investment firm failed to comply with duties of care in the context of order execution, provided there are rules to comply with in the given case, such as the giving of a warning or the request to provide a margin payment which may have a dissuasive effect on the investor-client and add to the understanding of the risks involved.[722] Each of these scenarios is based on the allegation that but for the breach, another investment decision would have been taken, allegedly with less or even no harm as a result. Put differently, this kind of claims is centered on the allegation that investors rely on the information, advice, warnings, recommendations etc. given by financial service providers (reliance model) and would have behaved and invested differently in absence of the breach.

Although the approach to transaction causation in the context of investment services is thus quite straightforward and in line with the underlying goals of the rules of conduct, its implementation raises considerable difficulties in legal practice. The difficulty particularly lies with the burden of proof on the claimant to establish evidence of the allegation that another investment decision would have been made in absence of the established wrongdoing.

II. The establishment of transaction causation in financial services litigation in courts: burden of proof and facilitations vis-à-vis (retail) investors

196. As explained earlier in this thesis, violations of conduct of business rules and disclosure obligations in the context of financial services legislation are mostly litigated under the (pre)contractual liability doctrines or, as in the UK under statutory torts as s.138D FSMA and the Misrepresentation Act 1967. This section examines how courts deal with the requirement of transaction causation in the context of defective investment services. The pre-MiFID as well as post-MiFID case law is analyzed in this regard.

A. Stringent approach towards transaction causation

197. Transaction causation requires the claimant to prove that he would have taken another investment decision in absence of the wrongful behavior on the side of the defendant-financial service provider. In its strict and rigorous application, the requirement of causation poses serious problems as to how an investor can produce such evidence, as is also illustrated by relevant case law. In two cases decided by the Brussels and the Amsterdam Court of Appeal respectively, the investor-claimants sued the investment service provider based on an alleged breach of the obligation to warn the clients for the risks related to the particular investments they had been informed about.[723] The first case concerned the execution of multiple orders passed by an average retail investor ('*client profane*').[724] As the client

[722] See for example: (<u>the Netherlands</u>) Hof 's-Hertogenbosch 22 June 2010, LJN BM9516, (X./ Abn Amro Bank Nv), available at www.rechtspraak.nl; Rb 's-Gravenhage 7 September 2005, (Nabbe/Staalbankiers), r.o. 3.18-3.19; Hof 's-Gravenhage 28 February 2008, LJN BC9455, *JOR* 2008/102, with ann. by F.M.A 't HART; (<u>Belgium</u>) Brussel, 23 March 2006, *TBH* 2008, 80.

[723] Brussel, 23 January 2004, *TBH* 2006, 112; Hof Amsterdam, 16 September 2008, LJN BF0810, (Stichting Spirit/Aegon Bank N.V.).

[724] Brussel, 23 January 2004, *TBH* 2006, 112-116, with ann. 116-118. See for a discussion of this case in the light of the causation requirement also: KRUITHOF, 'A different approach', 160; and BUYLE, 'Les obligations d'information', 200. See also: Brussel, 23 March 2006, *TBH* 2008, afl. 1, 80-84, with ann. by B. CAULIER, 85-86. In the latter case, no wrongful behavior was established though the court pointed out that even if a wrong would have been proven, no damages could be awarded unless the claimant also proves other investments would have been made had a margin been required. See also: H. JACQUEMIN, 'Focus sur certains mécanismes de protection du consommateur de produits et services financiers en matière contractuelle', X., *Cahiers AEDBF/EVBFR-Belgium - Bescherming van de consument in het financieel recht = La protection*

invariably traded in the same instrument in a speculative manner, the court held that the intermediary's failure to warn the client on the risks involved, constitutes a violation of the duty of care. The intermediary was nonetheless not held liable for the loss because the investor-claimant failed convince the court that he would have altered his strategy in case he had received a warning. The court reasoned that it could not be assumed that the warning would have prevented the investor-claimant to carry out the speculative transactions as it is customary under investors to hold on to disappointing investments in order to await improvements that may mitigate the loss or even offer recovery. As a result, the court considers the claimant's allegation that he would have changed course after receiving a proper warning implausible and therefore rejects the claim.

Similarly, the Amsterdam Court of Appeal considered a securities leasing case brought by an ad hoc association that bundled numerous claims from allegedly aggrieved investors (*Stichting Spirit*).[725] Assessing the alleged wrongful behavior of the bank-defendant, the latter was found to have failed to comply with the disclosure regulation for it did not warn the investors for the considerable risks relating to investment strategies involving borrowed money. Second, the Amsterdam court also found that the bank had misjudged the suitability of the investment as a consequence of its failure to obtain relevant information on the financial background and income position of the investor-claimants.[726] In its assessment of the causal link between these established violations and investment decision made by the claimant however, the court held that the latter had not presented persuasive evidence that in case the bank had complied with its obligations, the investors would have reached another decision.[727] Indications or guidelines as to how an investor could establish such evidence are not elaborated on in the decision however.[728]

198. These illustrations raise questions on how an investor-claimant can establish proof of reliance on the information or advice given by the financial service provider in. Since reliance is a subjective element, it is very hard to establish objective evidence that one would have acted differently but for the violation of law before a court. The causal question as to what the investor would have decided in absence of the wrong is hypothetical and highly difficult to answer from hindsight. In some instances,

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du consommateur en droit financier, vol. 11, Antwerpen, Intersentia, Anthemis, 2012, 149. With regard to the latter decision: Brussel, 16 March 2009, *TBH* 2011, afl. 4, 338; *TBBR* 2010, 353 with ann. by H. JACQUEMIN; *Bank. Fin. R.* 2009, 237.

725 Hof Amsterdam, 16 September 2008, LJN BF0810, (Stichting Spirit/Aegon Bank N.V.). The securities leasing products were offered on a wide scale to thousands of potential investors. As many of the investments caused the investors to suffer considerable losses, a stream of litigation was produced by disappointed investors filing claims against the banks that had distributed the investments. A considerable number of these investors bundled their claims, either via existing organizations specialized in representing collectives of investors or otherwise via ad hoc organizations and foundations set up especially with regard to the securities leasing litigation. The details of the Dutch securities leasing litigation are discussed further below, see *infra* para. 210.

726 Hof Amsterdam, 16 September 2008, LJN BF0810, (*Stichting Spirit/Aegon Bank N.V.*), r.o. 6.4.5. and 6.5.5.

727 In this case, there was the additional difficulty for the association representing the investors to deliver evidence of transaction causation for each and every investor represented. In an attempt to overcome the problem of individualized evidence per represented investor, the association submitted surveys that had been sent to each investor to be completed. The court deemed those surveys not sufficient as it required more specific and individualized information on each investor and the circumstances and facts related to the investment decisions made by these investors. Hof Amsterdam 16 September 2008, LJN BF0810, (*Stichting Spirit/Aegon Bank N.V.*), r.o. 6.5.6. and r.o. 6.5.7.

728 Idem. See for a similar decision, though in the sphere of contractual liability: CA Luxembourg, 11 March 2009, n° 33287, *ALJB – Bull. Droit & Banque,* 2009, 71, citing the judgment in first instance, issued on 14 November 2007 in the same sense. The appellate court held that the bank-advisor failed to respect the client's investment objectives and did not ensure a well diversified investment strategy. The portfolio was highly dependent on the evolutions in the new technology field. Even though the court considered the breach (i.e. unsuitable advice) on the side of the bank-defendant proven, the claim was rejected as the court found that the investor had not proven that he would have decided to invest differently in case of suitable advice. Additionally, no evidence had been presented that even if other investments had been chosen in case of adequate advice, no or less loss would have been suffered (loss causation).

certain facts or circumstances such as the reactions of the investor-claimant on similar previous occasions may be indicative of whether a claimant was likely to have acted differently without the wrongful act. In a decision delivered by the appellate court of Amsterdam for instance it was held that since the claimant had not adjusted the composition of the portfolio in response to sharp declines in value in 2001 (in the aftermath of the September 11 events), it could not be assumed that he would have done so if a warning regarding the potential risks had been given by the bank-defendant.[729] In another decision, transcripts of the communication and correspondence between the parties proved that the investor-claimant was well aware of the risks he was taking despite the lack of explicit warnings that should have been given by the bank.[730]

199. Oftentimes, however, no such indications are available. In those instances, investor have often found the burden of proof too high to meet, calling into question whether this approach is not too harsh and even undesirable from an investor protection point of view.[731] The reason why duties of care are imposed on financial service providers is precisely to protect investors against unsuitable or ill-considered investments. To the extent investors are precluded from compensation as a result of procedural barriers that are often too high to meet, the effectiveness of the regulation and investor confidence in financial service providers may be undermined.[732] Along the lines of these considerations, it should not come as a surprise that courts have tried to alleviate the burden of proof vis-à-vis the investor-claimant to overcome the problem of (proving) uncertain causation. The solutions and techniques developed by the courts (and legislators) are discussed in more detail in the text below. A distinction is made between those solutions that could be referred to as 'traditional' solutions, in the sense that the 'all or nothing' approach to causation is left unaffected on the one hand, and solutions that deviate from this approach. The most notable and frequently applied example of the latter can be found in France, where the courts commonly resort to the doctrine of the loss of a chance. In the Netherlands, a Dutch variant of this theory was developed, being the doctrine of proportional liability.

B. Facilitations through traditional techniques in civil liability law

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[729] Hof Amsterdam 2 November 2010, LJN BP7735, (Prenger/ABN Amro NV), *JOR* 2011/80, r.o. 4.8. Similar: Hof Amsterdam, 31 January 2012, LJN BV7171, (X./ABN Amro), *JOR* 2012/115, in particular: considerations 3.17 and 3.18, with ann. by K. FRIELINK. See also: C. BENICKE, *Wertpapiervermögensverwaltung*, Tübingen, Mohr Siebeck, 2006, 853. *Comp*. (UK): *Bank Leumi (UK) plc v. Wachner*, (2011), 1 C.L.C. 454, at 315.

[730] Hof Amsterdam 13 March 2012, LJN BW9464, available at www.zoeken.rechtspraak.nl. See in this context also the decision issued by the Amsterdam Court of Appeal in which it was decided that no causal connection could be withheld between the lack of an investor profile and/or warnings regarding the risks involved on the one hand, and the investment decisions made by the claimant on the other. The court found that the warnings would not have made any difference in terms of the investment decisions and strategy on the side of the claimant-investor since the latter engaged in highly similar investments based on an identical strategy and highly similar portfolio only a few months after having suffered considerable losses. Hof Amsterdam 31 January 2012, LJN BV7171, (X./ABN Amro), *JOR* 2012/115, in particular considerations 3.17 and 3.18, with ann. by K. FRIELINK. The court in first instance came to a similar conclusion for the same reasons, see Rb Amsterdam, 15 September 2010, case nr. 435337 / HA ZA 09-2545, unpublished, but mentioned in the aforementioned appellate decision.

[731] KRUITHOF, 'A different approach', 160; See also the comment of JACQUEMIN on Brussel, 16 March 2009, stating that the court's approach to causation is too strict. Brussel, 16 March 2009, *TBH* 2011, nr. 4, 338; *TBBR* 2010, 353 with ann. by H. JACQUEMIN; *Bank. Fin. R.* 2009, 237; A.C.W. PIJLS, 'Het bewijs van causaal verband bij informatieverzuimen in de beleggingspraktijk', *NTBR* 2009, nr. 5, 171; A.J.P. SCHILD, 'Het 'condicio sine qua non'-verband bij de schending van een zorgvuldigheidsverplichting: enige wegen naar Rome', *Rechtsgeleerd Magazijn THEMIS*, 2009, afl. 6, 263. Similar: (Austria) H. KOZIOL, 'Incorrect advice to investors and the liability of banks', 74 *THRHR* 2011, also available at ssrn: http://ssrn.com/abstract=2016797, 10; BYDLINSKI, 'Fehlerhafte Anlageberatung', 168 ff.

[732] See for instance: PERRONE and VALENTE, 'Investor protection in Italy', 31. See also: PIJLS, 'Informatieverzuimen', 171. See also: SCHILD, 'Condicio sine qua non'-verband', 263.

1. The introduction of rebuttable presumptions of reliance

a. The German 'Vermutung aufklärungsrichtigen Verhaltens'

200. Concept. – A first solution to overcome the difficulty in establishing reliance in the context of financial services is the use of a presumption of reliance, or put differently, the reversal of the burden of proof. A notable example of this approach is found in Germany, where a rebuttable presumption has been established by the courts and applies to liability claims based on erroneous advice provided by financial intermediaries, including asset managers and financial advisers. This rebuttable presumption is generally referred to as the '*Vermutung aufklärungsrichtigen Verhaltens*', which can be translated as a 'presumption of advice-conform behavior' or 'assumption of appropriate behavior'.[733] This presumption was employed by the German Supreme Court in 1973[734], and further developed and refined through consecutive court decisions.[735] The German Supreme Court justified the introduction of the presumption on the grounds of the underlying rationale of the information duties violated by the investment service provider (§280 BGB).[736] The court particularly found that since the rules were intended to allow the client to make an informed decision, a violation of these information obligations must be considered causally related to the investment decision made by the client because the latter can by no means present convincing evidence as to whether another decision would have been made had he been correctly and completely informed. In short, the court motivated its decision by the

[733] The translation (advice-conform behavior) was used in: J.D. JANSEN, 'Case note - Judgment of the Bundesgerichtshof (Federal Court of Justice of Germany) of 22 March 2011: Passion to inform - BGH expands banks' advisory duties', 12 *GLJ*, 2011, (1492) 1506; see also: R. JORDANS, 'Information duties about Payments Received for Distribution of Financial Products - An Overview of German Case Law', 28 *JIBLR*, 2013, iss. 1, 18. See on this presumption also: SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, n° 82 – n° 86; ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §4, para. 112 and para. 116, §23, para. 56; CASPER and ALTGEN, 'Germany', 124, para. 4.118; BALZER, 'Vermögensverwaltung', §51, para. 59; M. HABERSACK, 'Anlegerschutz im Wertpapiergeschäft – Grundsatz- und Praxisfragen', M. HABERSACK, *Anlegerschutz im Wertpapiergeschäft AGB in der Kreditwirtschaft*, Berlin, de Gruyter, 2011, 34; J. ELLENBERGER, 'Neue Rechtsprechung zur zivilrechtlichen Haftung beim Vertrieb von Kapitalanlagen', M. HABERSACK, *Anlegerschutz im Wertpapiergeschäft AGB in der Kreditwirtschaft*, Berlin, de Gruyter, 2011, 48; SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1744; F.A. SCHÄFER and J. MÜLLER, *Haftung für fehlerhafte Wertpapierdienstleistungen*, Köln, RWS Verlag, 1999 31, para. 72 and references cited; P. MANKOWSKI, *Beseitigungsrechte*, Tübingen, Mohr Siebeck, 2003 210 ff. Compare the German '*Vermutung aufklärungsrichtigen Verhaltens*' also with its Swiss (less firmly established and less frequently used) equivalent, the '*Vermutung aufklärungskonformen Verhaltens*', see for instance: Bundesgericht, 7 October 1997 (BGE 124 III 155 E. 3d S. 165, also available at: http://www.bger.ch. The decision refers to its German equivalent. See for this decision and other references also: ROSAT, *Der Anlageschaden*, 140-141; A. RUSCH, 'Auskehr in der Schweiz, Schadenersatz in Deutschland?', *WM* 2012, 440 ff.

[734] BHG 5 July 1973, *BGHZ* 61, 118, 122, *WM* 1973, 1015. See extensively on this decision: GEIBEL, *Der Kapitalanlegerschaden*, 150 ff.

[735] BGH 9 June 1998, XI ZR 220/97, *WM* 1998, 1527; BGH, 12 May 2009, XI ZR 56/05, *BGHZ* 170, 226; BGH, 12 May 2009, X ZR 586/05; BGH 26 February 2013, XI ZR 318/10, *BKR* 2013, heft 5, 212; BGH 22 March 2011, XI ZR 33/10, available at http://juris.bundesgerichtshof.de; BGH, 9 February 2006, *WM* 2006, 668; BGH, 24 August 2008, XI ZR191/10, *NJW* 2011, 3231; OLG München, 12 July 2010, *WM* 2010, heft 40, (1895) 1897; OLG München, 13 July 2010, *BB* 2010, heft 46, 2782; OLG Karlsruhe, 7 May 2010, *WM* 2010, heft. 27, (1264) 1268-1269; LG Frankfurt a.M., 1 March 2010, *WM* 2010; heft. 28, (1317) 1319-1320; LG Osnabrück, 23 April 2010, *WM* 2010, heft. 29, (1358) 1361; OLG Stuttgart, 20 April 2011, *WM* 2012, heft 36, 1719; LG, Hamburg, 23 June 2009, *BB* 2009, heft 35, 1828-1832, with ann. by S. BAUSCH, 1832-1833; OLG Düsseldorf, 8 July 2010, *WM* 2010, heft 41, (1934) 1937; OLG Naumburg, 9 February 2010, *WM* 2010, heft 25, (1165) 1169; OLG Dresden, 3 April 2012, *ZIP* 2012, heft 40, 1952; OLG Oldenburg, 24 September 2008, *WM* 2009, 304; LG Heidelberg, 17 January 2012, *BB* 2012, heft 6, 330; OLG Stuttgart, 14 December 2011, *BB* 2012**,** 130; *WM* 2012, 890; OLG Stuttgart, 27 October 2010, *BB* 2010 heft 3, 139; LG Heidelberg, 15 December 2009, *WM* 2010, 505; LG Würzburg, 31 March 2008, *ZIP* 2008, 1059; *WM* 2008, 977; OLG Frankfurt, 17 February 2010, *BB* 2010, heft 15, 853-855, with ann. by S. BAUSCH, 855-856. In a procedure before the German federal constitutional court ('*Bundesverfassungsgericht'*) the latter declared the '*Vermutung aufklärungsrichtigen Verhaltens*' constitutional, see: BVerfG, 8 December 2011, 1 BvR 2514/11, *ZIP* 2012, heft 4, 164-167. For more references and a detailed overview of the relevant case law, see: *Ibid.*, 148-158.

[736] PALANDT (ed.), *Bürgerliches Gesetzbuch*, §280, para. 37, 39.

difficulties investors encounter in their attempt to obtain compensation for claims following a breach of precisely those rules aiming to protect them from this type of mishaps (‘*Schutzzweck’*).[737]

201. The concept of the jurisprudential ‘*Vermutung aufklärungsrichtigen Verhaltens*’ has not remained confined to the German context though. In a decision dating back to 1997, the Swiss *Bundesgericht* (or ‘Tribunal Fédéral’, Swiss Supreme Court) applied a very similar – if not identical – presumption (‘*Vermutung aufklärungskonformen Verhaltens*’) to reverse the burden of proof regarding causation in the context of a breach of precontractual information obligations vis-à-vis an investor-claimant.[738] Similar to the German court, the Swiss Supreme Court reasoned that in a normal course of events an investor complies with the advice and warnings given to him by a professional. The Swiss court repeated and confirmed this holding in a more recent decision[739] causing academics to discern a potential gradual evolution towards the establishment of a (general) presumption of causation.[740]

202. Scope. – The German presumption of causation applies in case the defendant violated a *precontractual* or a *contractual* duty to provide information or to give advice. According to the presumption, it is assumed that the investor-client relies on the advice or information to reach a decision. Since investors are assumed to rely and act on the advice or information provided to them, it is presumed that in case the investor-claimant had been informed or advised differently (i.e. more complete and correct), he would have decided on another, better suited investment in response to the advice or information.[741] In the context of precontractual information obligations, the presumption applies when misleading information or unsuitable advice has been provided, but also in case relevant information or warnings were omitted. With regard to contractual information obligations, it has been held that in case financial service providers neglect the duty to report to the client, it may be assumed that the client would have taken the steps necessary to prevent the occurrence of (more) loss. For instance, consequent to the finding that an asset manager violated his duty to inform the investor-client of a considerable decline in portfolio value, the court presumed that if the asset manager had complied with his duty, a reasonable investor (‘*vernünftiger Anleger*‘) would have terminated the contract to avoid additional losses.[742]

203. Until recently, the presumption of causation was conditional upon the requirement that a specific alternative investment or investment strategy was available in absence of the wrong. In case no specific alternative could be singled out and instead several alternative investment decisions appear

[737] BENICKE, *Wertpapiervermögensverwaltung*, 848-849; GEIBEL, *Der Kapitalanlegerschaden*, 150 ff.

[738] Bundesgericht, 7 October 1997 (BGE 124 III 155 E. 3d S. 165, availabe at: http://www.bger.ch). See for this decision and other references also: ROSAT, *Der Anlageschaden*, 140-141.

[739] Bundesgericht, 13 June 2008, 4C.68/2007, availabe at: http://www.bger.ch, cons. 8.1. For an annotation on this decision, consult: T. STEININGER and H.C VON DER CRONE, 'Beratungsauftrag und Aufklärungspflichten', *SZW/RSDA*, 2009, nr. 2, 140-151; See also: ROSAT, *Der Anlageschaden*, 140-141.

[740] ROSAT, *Der Anlageschaden*, 141; the author also discusses the criteria and indications that may be relevant in the assessment of causation. See also: M. MOSER, *Die Haftung gegenüber vertragsfremden Dritten*, Bern, Stämpfli Verlag AG, 1998, 197-198. MOSER states that over time the courts have eased the difficulties claimants encounter in attempting to establish proof of what they would have decided or done in absence of the breach; RUSCH, 'Auskehr in der Schweiz, Schadenersatz in Deutschland?’, 440.

[741] SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 83-84; PALANDT (ed.), *Bürgerliches Gesetzbuch*, §280, para. 37, 39; M. GEBAUER, *Hypothetische Kausalität und Haftungsgrund*, Tübingen, Mohr Siebeck, 2007, 375 ff.; ELLENBERGER, 'Neue Rechtsprechung', 49; CASPER and ALTGEN, 'Germany', 124, para. 4.117.

[742] “Es ist zu vermuten, daß sich der Kläger nach Unterrichtung über den erheblichen Erstverlust […] in nur fünf monaten aufklärungsrichtig verhalten hätte. Dies entspricht der Rechtsprechung des BGH in Banksachen […]. Bei Information über den eingetretenen Verlust in kurzer Zeit hätte ein vernünftiger Anleger den Verwaltervertrag beendet.“ OLG Hamm, 28 December 1995, *WM* 1996, (669) 671. See also on this decision: BALZER, 'Vermögensverwaltung', 1500, para. 59.

plausible in case adequate advice or information had been provided (‘*Entscheidungskonflikt’*), the presumption failed to apply.[743] Not all courts adhered to the limitation of the ‘*Entscheidungskonflikt’* however. Assessing an investor claim following erroneous financial advice, the *Landesgericht* in Heidelberg considered that the presumption as introduced by the German Supreme Court is rendered pointless if the mere existence of theoretically possible alternatives suffices to preclude the employment of the presumption.[744] Hence, the presumption must be applied if information relevant to an investor has been omitted, regardless of the various investments that can be advanced as alternative possibilities. Another point of view would deprive the presumption of its substance since alternatives are always – at least theoretically – available to investors, according to the Heidelberg court. In a recent decision the German Supreme Court confirmed this reasoning and rejected the limitation based on the ‘*Entscheidungskonflikt’*-doctrine in similar terms as the Heidelberg court.[745] The decision was not entirely unexpected since the German Supreme Court had already taken a rather relaxed stance on previous occasions.[746] The decision handed down in May 2012 continues along those lines and leaves no further doubt as it holds that regardless of whether only one or a range of other investments qualifies as reasonable alternative(s) to the investor-claimant, the presumption of causation applies.[747]

204. Overall, it can be concluded that the presumption has a relatively broad scope and is frequently applied in a wide variety of cases. Examples include cases involving violations of the disclosure rules regarding inducements,[748] misleading prospectus information by investment funds[749],

[743] BGH, 13 July 2004, XI ZR 178/03, *WM* 2004, 1774; *BB* 2004, 1981; BGH, 9 March 2011, II ZR 191/10, *WM* 2011, (925) 928; BGH, 7 May 2002, XI ZR 197/01, *WM* 2002, 1442; *BB* 2002, 1504; BGH, 22 March 2010, *WM* 2010, 972: BVerfG, 8 December 2011, *WM* 2012, heft 2, 68; OLG Stuttgart, 27 June 2012, *WM* 2012, heft 38, 1829. See also: D. EINSELE, *Bank- und Kapitalmarktrecht – Nationale und Internationale Bankgeschäfte*, Tübingen, Mohr Siebeck, 2010, §8, para. 43a; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, paras. 82-86; ELLENBERGER, 'Neue Rechtsprechung', 49.

[744] LG Heidelberg, 15 December 2009, *WM* 2010, 505.

[745] BGH, 8 May 2012, XI ZR 262/10, *ZIP* 2012, 1335; *WM* 2012, 1337; annotation by A. CONEN, *GWR* 2012, 349. See also extensively: T.M.J. MÖLLERS, 'Die Vermutung aufklärungsgerechten Verhaltens', *Anlegerschutz im Wertpapiergeschäft. Verantwortlichkeit der Organmitglieder von Kreditinstituten: Bankrechtstag 2012*, Berlin, Walter de Gruyter, 2013, 85 ff.

[746] An earlier decision for instance held that the presumption may apply despite the existence of a number of alternatives, provided that under each of the alternative scenarios a better outcome would have been the result (BGH, 7 May 2002, XI ZR 197/01, *BB* 2002, 1504; *WM* 2002, 1442; *ZIP* 2002, 1238; also available at http://juris.bundesgerichtshof.de. See also: SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, 432, para. 82). Alternatively, in a decision concerning the investment in a real estate fund following misleading information, the BGH held that since investors seeking to invest in the real estate sector generally look for certainty, profitability and protection against future inflation, these investor would have invested in equally ‘safe’ investments in absence of the wrongful information. The court added that as a matter of principle, the presumption should apply, while exceptions are generally only justified in case it concerns highly speculative investments. (BGH 22 March 2010, II ZR 66/08, *BB* 2010, heft 26, 1553, with ann. by K. PÖRNBACHER and Ph. MASSARI, ‘Kausalitätsvermutung nur bei wirtschaftlich bedeutsamen Prospektfehlern‘).The appellate court had rejected the application of the presumption as it found that the alternative the investor would have chosen in absence of the wrongful prospectus information was undistinguishable. KG Berlin, 13 February 2008, 26 U 102/7, unpublished but discussed in the aforementioned court decision and comment.

[747] BGH, 8 May 2012, XI ZR 262/10, *ZIP* 2012, 1335; *WM* 2012, 1337; with ann. by A. CONEN, *GWR* 2012, 349. With this decision, the BGH reversed the former tendency to narrow the scope of the presumption. See also: S. BAUSCH and K. KOLHMANN, 'Anforderungen an die Widerlegung der Schadensursächlichkeit nach der Rechtsprechungsänderung des XI. Zivilsenats', *BKR* 2012, heft 10, 410-414; (critical) M. BASSLER, 'Die Vermutung aufklärungsrichtigen Verhaltens - kritische Würdigung der richterrechtlichen Beweislastumkehr im Kapitalanlageberatungsrecht', *WM* 2013, heft 12, 544.

[748] BGH 26 February 2013, XI ZR 318/10, *BKR* 2013, heft 5, 212. Inducements are the remunerations financial intermediaries receive from third parties with whom the intermediaries have dealt regarding the clients investments, similar to the so-called inducements. Although the exact legal position on the duties related to inducements is discussed in Germany, it is established that the intermediary has the obligation to disclose the kickback policy in case relevant. For instance, in cases of investment advice where the intermediary recommends investments and is remunerated for his recommendations by a third party offering or else how related to the recommended relation, the advisor is obliged to disclose precise information as to the kickback policy (BGH, 20 January 2009, XI ZR 510/07, *ZIP* 2007, 518; 12 May 2009, XI ZR, BB 2009, 1718-1720 with ann. by H. EDELMANN, 'Aufklärung über Ruckvergütungen bei allen Kapitalanlageproducten zukünftig geboten?’, *BB* 2009, 1720-1721; *NJW* 2009, 2298. See for instance also: SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, 432, §21, n° 84. On the kickback litigation, see more extensively: E. ALEXANDRIDOU, 'The Lehman Brothers Financial Products and the right to

erroneous financial advice and violations of rules of conduct, such as the 'know your customer' obligation by financial service providers in general.[750]

205. Rebuttal of the presumption. – The presumption may be refuted by the defendant, for instance when the latter demonstrates that the investor would not have acted any differently in case the defendant had complied with his obligations.[751] For example, if the investment was chosen because of particular tax advantages that were otherwise not available, there might be an argument that the investor-claimant would not have acted differently had he been adequately informed on the risks.[752] Alternatively, in case the defendant proves that the investor was aware of the extreme speculative character of the investment regardless of the defendant's failure to provide adequate information in that regard, the presumption is equally cast aside.[753] Other elements supporting evidence on the claimant's hypothetical behavior may be based on past investments and/or even subsequent investment decisions.[754]

206. Criticism. – Even though the presumption became firmly rooted in the case law, it also became the subject of criticism in the literature. Some have argued that the presumption fails solve the underlying problem of uncertain causation and simply shifts it to the defendant, who has similar difficulties and hardly a better chance to rebut the presumption in practice.[755] It has therefore been argued that the flexibility with which the presumption is applied, is disproportional in effect vis-à-vis the wrongdoers.[756] BENICKE therefore suggested abandoning the technique of the rebuttable

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compensation of European investors', in S. GRUNDMANN and Y.M. ATAMER, *Financial services, financial crisis and general European contract law*, Alphen aan den Rijn, Wolters Kluwer, 2011,,202-218; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, 432, §21, n° 83. The application of the '*Vermutung aufklärungsrichtigen Verhaltens*' in the context of the inducements has been criticized in the literature. H. EDELMANN for instance considers the presumption ill-fitted in this context because even if the investors would have known that – according to industry practices – provisions were being paid to the advisors and asset managers, investors would not have thought differently on the offered products or services, provided that the provisions did exceed industry standards and remained within certain limits (EDELMANN, 'Aufklärung über Ruckvergütungen', 1720-1721). For a similar critique see also: CASPER and ALTGEN, 'Germany', 125, para. 4.119 and references cited; H. EDELMANN, 'Die Kick-back-Rechtsprechung - ein Irrweg?', *BB* 2010, heft 20, 1163-1172; W. STUMPF and D. HETTENBACH, 'Zur (fehlenden) Kausalität unterlassener Aufklärung über Rückvergütungen', *BB* 2012, heft 42, 2582. On the German (BGH) case law concerning inducements, see also: JORDANS, 'Information duties', 18.

[749] The application of the presumption in claims concerning misleading prospectus claims is limited to those claims based on general civil liability law in a strict sense, which excludes claims brought conform the specific statutory regime under the former §44-45 BörsG (currently §§21-25 WpPG) for example. See also: BGH, 22 March 2010, II ZR 66/08, *BB* 2010, heft 26, 1553-1556 with ann. by K. PÖRNBACHER and Ph. MASSARI, 'Kausalitätsvermutung nur bei wirtschaftlich bedeutsamen Prospektfehlern'; BGH, 8 July 2010, III ZR 240/09, *BB* 2010, heft 34, 2005, with ann. by S. LANG and M. MÜLLER-FELSCH, 'BGH-Urteil hat weitere Vereinfachung der Anspruchsbegründung seitens des Anlegers zur Folge'.

[750] BGH, 22 March 2010, II ZR 66/08, *BB* 2010, 1553-1556 with ann. by K. PÖRNBACHER and Ph. MASSARI, 'Kausalitätsvermutung nur bei wirtschaftlich bedeutsamen Prospektfehlern'. See also: ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §24, para. 70.

[751] SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 82; BAMBERGER, 'Anlageberatung', 1468, para. 189.

[752] ELLENBERGER, 'Neue Rechtsprechung', 49-50. See also: GEIBEL, *Der Kapitalanlegerschaden*, 182; JORDANS, 'Information duties', 18.

[753] Extensively on the rebuttal of the presumption: BGH, 8 May 2012, *WM* 2012, heft 28, 1337. For a comment and assessment of the decision, see: BAUSCH and KOLHMANN, 'Anforderungen an die Widerlegung der Schadensursächlichkeit nach der Rechtsprechungsänderung des XI. Zivilsenats', 410-414.

[754] Idem.

[755] For some examples of cases in which the presumption was successfully rebutted, see para.205. See for a critical assessment also: BENICKE, *Wertpapiervermögensverwaltung*, 850; the author argues that the reversal of the burden of proof is too far reaching and backfires on the defendant since the latter is equally (un)likely to succeed in produce evidence to proof his allegation as the claimant. See also: GEIBEL, *Der Kapitalanlegerschaden*, 197.

[756] BENICKE, *Wertpapiervermögensverwaltung*, 850, 853. Asserting that the BGH case law has adopted an increasingly investor friendly-approach: S. LANG and M. MÜLLER-FELSCH,, BGH-Urteil hat weitere Vereinfachung der Anspruchsbegründung seitens des Anlegers zur Folge' in a comment on BGH, 8 July 2010, III ZR 240/09, *BB* 2010, heft 34, 2005.

presumption in favor of lowering the evidential threshold to a degree of preponderance ('*überwiegende Wahrscheinlichkeit'*).[757] It is noted that the discussion on the application of the presumption has especially arisen in cases where banks did not disclose the fact that inducements were received, i.e. remunerations for the distribution of financial products from third parties, without the investor being aware of the fact that commissions are received.[758] Notwithstanding the debate, however, the *Vermutung aufklärungsrichtigen Verhaltens*' remains firmly rooted in the German case law.

b. Belgian statutory presumption of causation

207. A second, quite recent example of a causal presumption to deal with evidential problems in the context of defective investment services, is the Belgian statutory presumption of transaction causation applicable in case of violation of (some of) the MiFID rules of conduct. More particularly, in accordance with art. 30ter of the Law on Financial Supervision, transactions effected by investors following a breach of one of the enumerated rules of conduct that cause the investor to suffer losses, are presumed to result from the breach, unless evidence to the contrary is presented. The transactions to which the presumption applies are broadly defined and include subscriptions to public offers and the purchase, retention and sale of financial instruments.[759] The enumerated rules of conduct include the duty to duly inform the investor, the 'know your customer'-obligation, the duty to provide suitable or appropriate services and to warn the client in case the financial intermediary considers an investment inappropriate for the particular client, given his profile and objectives. The presumption does not apply in case of breach of the general duty of care investment firms owe to their clients according to art. 27, §1 of the Law on Financial Supervision.[760] According to Belgian law, the rules of conduct and the presumption of transaction causation related to those rules, applies to various types of financial service providers, including credit institutions and investment firms, but also insurers.[761] As clarified in the explanatory memorandum to the law, only causation between the breach and the investment decision is presumed (transaction causation). The investor-claimant is still required to

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[757] BENICKE considers it unreasonable to put the full weight of proof on either party. It is clear to the author that facilitations must be provided for the claimant for the standard burden of proof is too heavy, though BENICKE considers a lowered evidential threshold preferable to a presumption, which essentially shifts the problem to the defendant. C. BENICKE, *Wertpapiervermögensverwaltung*, Tübingen, Mohr Siebeck, 2006, 850, 853. The degree of probability beyond which causation must be established is generally set at 'close to certainty' ('*an Sicherheit grenzenden Wahrseinlichkeit'*), comparable to the Belgian and French standards of evidence. In cases where parties typically encounter great difficulty in establishing proof conform that standard however, a standard of preponderance, meaning over 50 percent certainty, is applied to alleviate the burden.See also: WEBER, *Der kausalitätsbeweis im Zivilprozess*, 63. GEIBEL as well seems to support a lower evidential threshold and argues in favor of a probability assessment. See GEIBEL, *Der Kapitalanlegerschaden*, 180. ROSAT (arguing in context of the Swiss case law) on the other hand considers the use of presumptions reversing the burden of proof in the context of asset management suitable, especially since the second layer of causation offers possibilities to take the investor's profile and his individual preferences in terms of risk appetite and objective into account. See: ROSAT, *Der Anlageschaden*, 154. The current evidential threshold in Switzerland is the standard of preponderance ('*überwiegende Wahrscheinlichkeit'*). See also: RUSCH, 'Auskehr in der Schweiz, Schadenersatz in Deutschland?', 440 ff.

[758] See in this regard: JORDANS, 'Information duties', 18; CASPER and ALTGEN, 'Germany', para. 4.119; HABERSACK, 'Anlegerschutz im Wertpapiergeschäft', 35; EDELMANN, 'Die Kick-back-Rechtsprechung - ein Irrweg?', 1163.

[759] Art. 30ter, §2, Law on Financial Supervision.

[760] Art. 27, §1, Law on Financial Supervision (implementation of art. 19(1) MiFID).

[761] Art. 30ter, §1, Law on Financial Supervision. Note that the rules of conduct will be applicable to insurers too in Belgium as of January 1, 2014. The rules have been declared applicable to contracts for insurance linked to investments, life insurance and damage insurances by the law of 30 July 2013 (Wet tot versterking van de bescherming van de afnemers van financiële producten en diensten alsook van de bevoegdheden van de Autoriteit voor Financiële Diensten en Markten en houdende diverse bepalingen, *BS* 30 August 2013).

present evidence of the breach, the loss suffered, and the causal connection between the loss and the breach (loss causation).[762]

c. The development of (ad hoc) causal presumptions by Dutch courts

208. Similar to the German and more recently, the Belgian example, Dutch courts and literature show an inclination to presume transaction causation – and reverse the burden of proof as a result – in cases where financial service providers have violated their duties of care. Contrary to the relatively longstanding and generally accepted judicial '*Vermutung aufklärungsrichtigen Verhaltens*' and the express Belgian legislative provision, the Dutch courts seem to struggle in defining and marking the scope and substance of a presumption of transaction causation. More particularly, finding the employment of a general presumption of causation (by means of the reversal rule) unsuitable and contrary to the principles of evidential and procedural law, alternative solutions have been considered by courts and literature. Considering these alternatives, ad hoc presumptions seem to be the preferred solution by the Dutch Supreme Court, yet no clear and straightforward principle or rule has been developed in this regard.

209. The rejection of a general 'reversal rule'. – A first attempt to install a presumption of causation was carried out via the establishment of the rather general 'reversal rule', as it is referred to in the Dutch case law. Although originally confined to the area of traffic rules and medical liability cases, the reversal rule was expanded to cases of extra-contractual and precontractual liability in the *Dicky Trading II* decision of the Dutch Supreme Court in 1996.[763] The court particularly held that insofar harmful behavior gives rise to a certain risk that consequently materializes, the causal relation between the violation and the damage should be assumed unless the defendant successfully rebuts the assumption of causation.[764] The rather broad scope of application of the reversal rule was heavily criticized, however. Many commentators particularly argued that the reversal rule conflicted with the general principles of evidential and procedural law, being that claimants are supposed to bear the burden of proof, as laid down in art. 150 Rv.[765] Additionally, some pointed out that cases involving causal uncertainty should be decided on a case by case basis, allowing the courts to take the particular facts of each case into consideration, instead of simply imposing a theoretical causal presumption for the courts to apply, regardless of any factual assessment of the case and its circumstances. Over all, the

[762] Wetsontwerp tot versterking van de bescherming van de afnemers van financiële producten en diensten alsook van de bevoegdheden van de Autoriteit voor Financiële Diensten en Markten en houdende diverse bepalingen (I), *Parl. St.* Kamer 2012-2013, nr. 2872/001, 58.

[763] HR 26 January 1996, LJN AD2476, (Dicky Trading II), *NJ* 1996, 607. Confirmed in: HR 16 June 2000, LJN AA6233, (Stichting Sint Willibrord Psychiatrisch Centrum/X.), *NJ* 2000, 584 (particularly r.o. 3.4); HR 19 January 2001, LJN AA9556, (X./ Oude Monnink Motors B.V.), *NJ* 2001, 524; HR 2 March 2001, LJN AB0377, (Stichting Medisch Centrum Leeuwarden E.A./X.), *RvdW* 2001, 62. The two latter decisions also available at: http://zoeken.rechtspraak.nl.; A.S. RUEB (ed.), *Compendium van het burgerlijk procesrecht*, Deventer, Kluwer, 2009, 142; I. GIESEN, *Bewijslastverdeling bij beroepsaansprakelijkheid*, Deventer, Tjeenk Willink, 1999, 66.

[764] HR 26 January 1996, LJN AD2476, (Dicky Trading II), *NJ* 1996, 607. The Dutch Supreme Court justifies the rule on the general principles of reasonableness and fairness. RUEB (ed.), *Compendium van het burgerlijk procesrecht*, 143.

[765] BLOMSMA and VAN KESSEL, Bewijs en causaliteit, 22; PIJLS, 'Informatieverzuimen', 172; HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, 67, nr. 77; C.M.J. KLAASSEN, *Schadevergoeding, Part 2*, Deventer, Kluwer, 2007 61; H.J. SNIJDERS, annotation of HR 24 December 1999, *NJ* 2000, 428; C.E. DRION, 'Naar Haagse toestanden in het aansprakelijkheidsrecht?', *NJ* 2000, 1956-1959. See also: Conclusion Advocate-General HAMMERSTEIN, consideration 2.22 in HR, 3 February 2012, LJN BU4914, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), *JOR* 2012/116, with ann. by S.B. VAN BAALEN; *Ondernemingsrecht*, 2012 afl. 8, 340-343, with ann. by A.A ETTEMA; also available at www.rechtspraak.nl.

rule was criticized for being too claimant-friendly, offering too much leeway to frivolous claims.[766] Responding to the criticism, the scope of the reversal rule has been narrowed by the Dutch Supreme Court over time.[767] Prior to the more restrictive Supreme Court judgments however, some lower courts occasionally employed the reversal rule – though often without explicitly saying so – in the context of financial services liability.[768] The prevailing view expressed in courts[769] and in scholarly literature[770] however opposes the application of the reversal rule in the context of defective financial services. The reluctance displayed in both the literature and the case law is related to the fear that a clear acceptance of the reversal rule as a matter of principle may open the floodgates and allow investors far too easily to obtain compensation for disappointing investments. The broad resistance against the reversal rule may explain the new path taken by the Dutch Supreme Court in more recent decisions. In these decisions, a so-called 'ad hoc' presumption was introduced to be applied on a case by case basis.

210. The development of an 'ad hoc' presumption of causation: securities leasing litigation. – Following the mis-selling of securities lease products to thousands of investors, a stream of judicial decisions was generated and led to another attempt to deal with uncertain causation by means of a

[766] In his conclusion relating to a decision of the Supreme Court issued on 2 February 2007, A.-G. SPIER raised the question whether public interest would not better off without the reversal rule, with the exception of a single scholar and some professional litigators (HR 2 February 2007, LJN AZ4564, (Juresta Nederland B.V./X.), *NJ* 2007, 92, r.o. 4.22 and footnote (14), also available at www.rechtspraak.nl.

[767] HR 23 November 2001, LJN AB2737,(X./Stichting Gezondheidszorg, Oostelijk Zuid-Limburg), *NJ* 2002, 386, specifically r.o. 3.5.4 and 3.5.5; and HR 23 November 2001, LJN AD3963, (X./X.), *NJ* 2002, 387, r.o. 3.5.4; both decisions are also available at: www.rechtspraak.nl. The application of the reversal rule thus depends on the interest the violated rule aims to protect. Only to the extent that the loss that has materialized corresponds to the damage the rule aims to prevent, the causal presumption applies. This reasoning therefore shows interesting similarities with the relativity requirement. Relativity holds that prerequisite to having a cause of action following the breach of a rule, the damage for which redress is claimed must fall within the protective scope of the rule violated.

[768] In these cases, the courts assumed causation between the violations of the duty of care committed by the bank and the damages claimed by the investors without any reference to facts or other reasons on which the assumption of causation is based. The courts either referred to the circumstance that the defendant had not rebutted the causal connection, or found that the damages must be attributed to the breach since the rules that had been breached are investor protection measures aimed at preventing the damages that occurred in the given case. See for instance: GH Amsterdam, 9 December 2008, LJN 6261, (Dexia Bank Nederland N.V./X.), available at www.rechtspraak.nl., r.o.4.23 and 4.24; GH Amsterdam, 1 March 2007, LJN AZ9722, *JOR* 2007/97, r.o. 2.27; GH Amsterdam, 17 April, 2008, LJN BC9788, (X./ Dexia Bank Nederland N.V.), available at: www.rechtspraak.nl, r.o. 2.13; GH Amsterdam, 24 March 2007, LJN BA5684, (Levob Bank N.V./X,), available at www.rechtspraak.nl, r.o. 4.16; GH Amsterdam, 10 February 2009, LJN BH 2362, (Dexia Bank Nederland N.V./X.), *JOR* 2009/232, r.o. 4.26; Rb Alkmaar, 11 March 2009, LJN BH5774, (X./ING Bank NV), *JOR* 2009/136; GH 's-Hertogenbosch, 6 November 2007, LJN BB7875, (X./ Dexia Bank Nederland N.V.) available at www.rechtspraak.nl, r.o. 4.13.11. In the latter case, it is for instance stated that the causal link between the breach and the damage must be assumed since there are no indications that there is no causation, nor has the defendant contented that the causal connection is absent. The uncertainty relating to causation must therefore be attributed to the bank-defendant [own translation].

[769] See for example: GH Leeuwarden, 9 August 2006, LJN AY6106, (X./Van Lanschot Bankiers N.V.), available at www.rechtspraak.nl.; Rb Amsterdam, 24 January 2007, *JOR* 2007/94, (Laan/Wijs & Van Oostveen BV), with ann. by F.M.A. 'T HART; GH 's-Hertogenbosch, 22 June 2010, LJN BM9516, (X./ Abn Amro Bank NV), available at www.rechtspraak.nl, r.o. 4.15; Rb Amsterdam, 26 September 2007, LJN BB7169, (X./Degroof & Cie Vermogensbeheer B.V.), r.o. 4.10; GH Amsterdam, 16 September 2008, LJN BF0810, (Stichting Spirit/Aegon Bank N.V.), r.o. 6.5.6; Rb Amsterdam, 26 September 2007, LJN BB7169, available at www.rechtspraak.nl.

[770] See for instance: KLAASSEN, 'Bewijs van causaal verband', 137. See for a more extensive discussion on the matter: BUSCH, 'Het 'civiel effect' van MiFID', 75-76; DE JONG, *Schade door misleiding*, 262-268; see also: E. NEDERLOF-WOUTERS VAN DEN OUDENWEIJER and F. VAN DER WOUDE, 'Enige aspecten van aansprakelijkheid van de financieel adviseur voor teleurstellende beleggingsresultaten', *MvV* 2009, nr. 9, (215) 221; VAN BAALEN, *Zorgplichten*, 402-403. See also: C.H. VAN DIJK and F. VAN DER WOUDE, 'Privaatrechtelijke aansprakelijkheid van financiële dienstverleners voor het schenden van informatie-, onderzoeks- en waarschuwingsverplichtingen en de Wet op het financieel toezicht', *AV&S* 2009, afl. 11, 89; SCHILD, 'Condicio sine qua non'-verband', 259. *Comp.*: PIJLS, 'Informatieverzuimen', 173-174; BUSCH and SILVERENTAND, 'The Netherlands', 236, para. 7.149. See also: Conclusion Advocate-General HAMMERSTEIN, consideration 2.20 in HR, 3 February 2012, LJN BU4914, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), *JOR* 2012/116, with ann. by S.B. VAN BAALEN; *Ondernemingsrecht* 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; also available at www.rechtspraak.nl.

causal presumption in the context of financial services litigation.[771] The presumption was first established by lower courts and later on confirmed by the Dutch Supreme Court in the context of recent cases revolving around the securities leasing controversy in the Netherlands, involving thousands of claimants. For a correct understanding, a brief summary of the facts is useful.[772]

211. By the end of the nineties, financial institutions started offering financial products financed through securities leasing constructions to retail investors on a large scale. A wide range of products became available with diverging modalities and conditions, though a common feature of these products was that the investors agreed to raise a loan to finance the purchase of the securities portfolio.[773] The securities leasing constructions essentially implied two types of contracts, being on the one hand the loan agreement, and on the other the arrangement for the bank to acquire the securities package on behalf of the investor. Both these contracts were concluded with the same bank, which acted as a lender vis-à-vis the investor-client and simultaneously also as the financial advisor who acquired the securities on the investor-client's behalf. Since the investment was structured as a leasing construction[774], the investor became the owner of the securities only after the leasing period ended upon complete redemption of the loan and interest.[775] At the end of the leasing period, the investor has the choice to either keep the portfolio or sell it.[776] The construction involved a considerable tax advantage which contributed to the success of the construction and its large scale distribution.

[771] HR 5 June 2009, LJN BH2822, (Stichting Gedupeerden Spaarconstructie/Aegon), *JOR* 2009/200 and *RvdW* 2009, 685; LJN BH2815, (X./ Dexia Bank Nederland N.V), *JOR* 2009/199 and *RvdW* 2009, 683; LJN BH2811, (Levob Bank N.V./X.), *RvdW* 2009, 684; all cases are also available at: http://zoeken.rechtspraak.nl. In the literature, this presumption was called an ad hoc presumption, referring to its strong dependence on the factual circumstances of the matter at hand. See for instance: SCHILD, 'Condicio sine qua non'-verband', 254- 264; BUSCH and SILVERENTAND, 'The Netherlands', 236, para. 7.150.

[772] See also: A.C.W. PIJLS, 'Schade effectenlease-overeenkomsten deels vergoed', *MvV* 2009, nr. 10250-262; W.H. VAN BOOM and S.D. LINDENBERGH, 'Effectenlease: dwaling, zorgplicht en schadevergoeding', *AA*, 2010, 188-196; Y.A. WEHRMEIJER, 'Verdere duidelijkheid over afwikkeling van effectenleaseovereenkomsten: de wijze waarop Hof Amsterdam omgaat met de richtinggevende oordelen van de Hoge Raad', *MvV* 2010, nr. 2, 188-196; W.H. VAN BOOM, 'De beslissing van de Hoge Raad in de effecten-leasezaken', *TvC*, 2009, Nr. 6228-239; J.R. BRANBERGEN, 'De rechter in eerste aanleg in de aandelen-leaseprocedures', *NJ*, 2008, nr. 9, 498-502.

[773] The advantage of taking a loan up front and then partially repaying it consists of the leverage effect in case of an increase of the portfolio value. In case the increase is substantial by the time the loan matures, the investor succeeded in achieving a return he could never have achieved with his own limited means. On the down side however, in case the investment failed to meet the expectations, either by not meeting the expected increase in value, or even worse, in case the package of securities had lost value, the investor was left with the repayment of the loan.

[774] The investments were structured as leasing construction because of tax reasons. The interests paid on the loan entered into to finance the purchase of the portfolio were deductible under Dutch tax law.

[775] The modalities to redeem differed depending on the type of investment. On the whole, two basic types of investment can be distinguished. The first type implies that an investor invests a certain amount of money, substantially leveraged with a loan that was to be repaid by monthly redemptions. The monthly repayment included both part of the loan in sum and part of the due interest. At the end of the loan period, the investment could be sold off, by which a profit or loss could be realized in case of prospering stock prices, or the investor could keep the portfolio, for instance in case positive market evolutions were expected. The second type of investment requires repayment of the loan and interests only at the end of the loan maturity. The repayment is usually financed through the sale of the whole portfolio, which leaves the investor with a profit in case the portfolio had increased in value or a loss in case the portfolio value had declined over the leasing period.

[776] (Part of) the proceeds of a sale could then be used to repay the loan. See for the facts of the cases: HR 5 June 2009, LJN BH2822, (Stichting Gedupeerden Spaarconstructie/Aegon), *JOR* 2009/200 and *RvdW* 2009, 685; LJN BH2815, (X./ Dexia Bank Nederland N.V), *JOR* 2009/199 and *RvdW* 2009, 683; LJN BH2811, (Levob Bank N.V./X.), *RvdW* 2009, 684; PIJLS, 'Schade effectenlease-overeenkomsten deels vergoed', 250-262; VAN BOOM and LINDENBERGH, 'Effectenlease: dwaling, zorgplicht en schadevergoeding', 188-196; WEHRMEIJER, 'Verdere duidelijkheid over afwikkeling van effectenleaseovereenkomsten: de wijze waarop Hof Amsterdam omgaat met de richtinggevende oordelen van de Hoge Raad', 188-196; VAN BOOM, 'Hoge Raad effecten-leasezaken', 228-239; BRANBERGEN, 'De rechter in eerste aanleg in de aandelen-leaseprocedures', 498-502.

Following a sharp, general stock price decline around 2000 however, the investments made via the securities leasing constructions started to record considerable losses. Since the market situation only worsened from then on, numerous investors found themselves confronted with portfolios that would not enable them to repay their debts to the banks. A large number of investors failed to make the due redemptions, which resulted in the liquidation of the respective portfolios by the banks. Since the investors had agreed to acquire the portfolio on the condition precedent that they repay the loan, the banks were entitled to liquidate the portfolios in case of default. However, the proceeds often fell considerably short of satisfying the outstanding debt to the bank. Confronted with large amounts of remaining debt as a result, investors filed suit against the banks. Part of the claims was filed individually, while others decided to join collective actions organized by various investor associations, consumer organizations and ad hoc vehicles established specifically for this purpose.[777] The investors filed claims for restitution and annulment of the securities leasing contracts, and/or for compensation for breaches of the banks' duty of care and particularly violations of the rules of conduct and information duties. The claims were based on the common complaint that the banks had not adequately informed them about the risks, particularly with regard to the possibility that the investors would be left with debt after the portfolios were liquidated. Others argued that the banks had violated the 'know your customer'-obligations by recommending or offering unsuitable investments despite the lack of experience and sophistication on the side of the investors. In short, the problems with the securities leasing investments grew to become one of the largest battle fields between the banks and retail investors ever seen in the Netherlands.

212. Since the mass of claims threatened to clog the courts, the government ordered the formation of a special commission mandated to work out a settlement proposal. In 2005, a settlement proposal – generally referred to as the Duisenberg-proposal supported by the banks and several of the collective investor action organizations, was finalized. It offered (partial) compensation to aggrieved parties, provided they renounced their right to file suit.[778] Although many investors accepted the settlement, several others chose to opt out and instead filed and/or went on with individual claims before courts all over the Netherlands.

213. One of the recurring difficulties in the court procedures was the establishment of reliance in the sense that the investors were lead by the incorrect information and would not have concluded the securities leasing contracts with the banks and would instead have opted for other investments or would not have invested at all. Again, since this is a highly subjective matter, the establishment of such evidence proved troublesome and finally made its way to the Dutch Supreme Court. In deciding on the matter in three cases brought against respectively AEGON, DEXIA and LEVOB, the Dutch Supreme Court presented a framework within which not only the three specific cases could be dealt with in court, but also other similar future securities leasing suits.[779] As a result, the decisions handed down by the Supreme Court in June 2009 (also referred to as the June-decisions) can be regarded as a model for the lower courts in deciding on other similar securities leasing suits.

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[777] Amongst these investor associations for instance: Stichting Leaseverlies, Stichting Eegalease, Consumentenbond, Vereniging van Effecten Bezitters (VEB).

[778] The Duisenberg settlement proposal was declared legally binding to those involved by the Amsterdam Court of Appeal on 25 January 2007, in accordance with the relevant legislation (Hof Amsterdam 25 January 2007, LJN AZ7033, available at: www.rechtspraak.nl). See on this settlement proposal also: N.J.H. HULS, 'Is de Duisenberg-regeling royaal genoeg voor alle legitieme Dexia claims?', *NJ* 2005, afl. 27 1386-1390.

[779] See for these cases: HR 5 June 2009, LJN BH2822, (Stichting Gedupeerden Spaarconstructie/Aegon), *JOR* 2009/200 and *RvdW* 2009, 685; LJN BH2815, (X./ Dexia Bank Nederland N.V), *JOR* 2009/199 and *RvdW* 2009, 683; LJN BH2811, (Levob Bank N.V./X.), *RvdW* 2009, 684; all cases are also available at: http://zoeken.rechtspraak.nl.

214. Along the line of argumentation brought forward by the claimants, the Supreme Court held that the bank, in this case Dexia, indeed failed to meet its obligations. The violations withheld by the court included the breach of the duty to adequately inform and warn the client-investor on the one hand, and the duty to examine the suitability of the investment in the light of the client-investor's experience, sophistication and his financial background on the other hand. With regard to the assessment of causation, the court considered that the causal relation must be examined for each of the distinct breaches of law and the types of loss claimed.[780] With regard to the assessment of reliance in the context of the (un)suitability of the investment, the court considered whether the investor would have concluded the contract if he had been advised not to do so based on the bank's assessment of his financial background and capacities.[781] The court concluded that in these cases causation should be assumed as the probability that an investor would have concluded the contract after an explicit discouragement and negative advice by the bank, was negligible.[782] In those cases where the investor-claimant would have proven creditworthy on the other hand, the court held that the existence of a causal connection between the bank's failure to warn for the risks related to the investment and the investment decision of the investor-claimant requires examination.[783] The omitted warning to which the court refers, concerns a warning on the possibility that the investment might cause the investor to be left with a residual debt after the liquidation of the investment portfolio. With regard to the question how transaction causation in this context must be approached, the court holds the following: only to the extent the *defendant* (i.e. the financial institution) presents sufficiently precise and supportive evidence to his defense that even had the investor-client been duly warned, the latter would not have acted differently, the court can accept this defense.[784] In other words, to the extent the bank/defendant fails to provide specific indications and support to its defense, transaction causation is considered established.

215. Assessment. – The decision of the Dutch Supreme Court is remarkable for several reasons. The attempt to derive causation, considered as a subjective element in terms of the impact of the breach on the decision or behavior of an investor, via an objective criterion such as the investors' financial strength is noteworthy. More particularly, with regard to investors who should have been advised against the investment based on their financial background, reliance is simply assumed, unless compelling indications to the contrary are brought forward.[785] For those investors considered sufficiently creditworthy to bear such investment and the risks related, the Court provides for a similar rebuttable presumption, stating that to the extent the defendant cannot support his defense with indicative and concrete evidence, it can be assumed that the investor-claimant would not have concluded the agreement but for the breach committed by the defendant. Notwithstanding the Court's explicit recognition of the evidential principle that the burden of proof is borne by the claimant[786], this is an unmistakable shift of that burden towards the defendant, or put differently, a rebuttable

[780] HR 5 June 2009, LJN BH2815, (X./ Dexia Bank Nederland N.V), *JOR* 2009/199 and *RvdW* 2009, 683; also available at: http://zoeken.rechtspraak.nl, r.o. 5.3 and 5.4.1. The causal nexus between the distinct breaches and the types of loss claimed concerns a matter of loss causation and is discussed further below.

[781] Idem, r.o. 5.4.3. and 5.5.1.

[782] Idem, r.o. 5.5.2.

[783] Idem, r.o. 5.5.3.

[784] Idem, r.o. 5.5.3. This approach is highly similar to the German '*Vermutung aufklärungsrichtigen Verhaltens'* that applies in cases where precontractual or contractual information obligations have been breached. See *supra*: para. 200.

[785] Hof Amsterdam 8 March 2011, LJN BP8466, (*Defam/X.*), available at www.rechtspraakzoeken.nl, para. 4.22;

[786] Idem, r.o. 5.4.2.

presumption of reliance.[787] Lower court case law has complied with the guidelines provided by the Supreme Court and put the theory into practice.[788] Reported decisions show that defendants generally fail to rebut the presumption of causation, illustrating the relevance of this landmark decision.[789]

216. The scope and relevance of the presumption of causation as stated in the securities leasing cases, and more particularly, to what extent this presumption might also apply beyond the securities leasing context is unclear.[790] The securities leasing litigation is in particular characterized by the fact that it concerned highly leveraged investment constructions distributed to (often fairly unsophisticated) retail investors on a mass scale. The scale of the litigation resulting from the controversy was unseen, clogged the lower courts and may have given rise to conflicting judgments adding to the uncertainty.[791] For these reasons, the Dutch Supreme Court attempted to answer the various questions brought forward in the particular case at hand in a general manner, drawing the outlines of a more general scheme that could be used by the lower courts to deal with the cases in uniform manner and avoid conflicting decisions that would have confused legal certainty and uniformity between the courts.[792] Policy reasons thus may have had an important impact on how the Supreme Court dealt with this particular case. In recent cases, the Supreme Court repeated that the rule that the burden of proof is on the claimant must be respected without clarifying how this relates to its earlier decisions in which presumptions were accepted, while nonetheless accepting the establishment of transaction causation with remarkable leniency.[793] The bottom line seems to be that the Supreme Court is unwilling to modify the basic principles governing civil procedure on a general basis, yet at the same time leniency is shown in regard of the assessment of causation depending on the particular circumstances of the case at matter.[794]

217. The application of causal presumptions by the lower courts. – The June-decisions introducing the rebuttable presumption of causation in the securities leasing litigation are not a secluded phenomenon however. As already mentioned in the preceding paragraphs, lower courts had already started applying rebuttable presumptions of causation before the securities leasing litigation reached the Supreme Court, as decisions of the Court of Appeal of s-'Hertogenbosch and the lower courts of Amsterdam and s'-Hertogenbosch clearly demonstrate.[795] In addition, similar presumptions

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787 In the same sense: PIJLS, 'Schade effectenlease-overeenkomsten deels vergoed', 260 ff.; SCHILD, 'Condicio sine qua non'-verband', 254-264.

788 Hof Amsterdam 8 March 2011, LJN BP8466, (*Defam/X.*), available at www.rechtspraakzoeken.nl; Hof Amsterdam 1 December 2009, LJN BK4978, (*Dexia Bank Nederland N.V./X.*), *JOR* 2010/66 with ann. by C.M.W. LIEVERSE; LJN BK4983, (*Dexia Bank Nederland N.V./X.)*.

789 Hof Amsterdam 1 December 2009, LJN BK4983; Hof Amsterdam 1 December 2009, LJN BK4978, *JOR* 2010/66 with ann. by C.W.M. LIEVERSE; Hof Amsterdam 26 April 2011, LJN BQ3067 (Defam/X.); Hof Amsterdam 7 June 2011, BQ7706, (Defam/X.); Rb Utrecht, LJN BM6964; Hof Amsterdam 8 March 2011, LJN BP8466. The decisions are available at: www.rechtspraakzoeken.nl.

790 See in this regard also: KLAASSEN, 'Bewijs van causaal verband', 147, 149.

791 PIJLS, 'Schade effectenlease-overeenkomsten deels vergoed', 250.

792 *Ibid.*250; KLAASSEN, 'Bewijs van causaal verband', 149.

793 See for instance: HR, 8 February 2013, LJN BX7846, available at uitspraken.rechtspraak.nl; HR, 3 February 2012, LJN BU4914, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), *JOR* 2012/116, with ann. by S.B. VAN BAALEN; *Ondernemingsrecht*, 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; with ann. by D. BUSCH, *Ars Aequi,* 2012, 752. For a similar conclusion: PIJLS, 'Informatieverzuimen', 172; KLAASSEN, 'Bewijs van causaal verband', 134; A. HAMMERSTEIN, 'Geschilbeslechting in financiële aansprakelijkheidszaken', D. BUSCH, C.M.J. KLAASSEN and T.M.C. ARONS, *Aansprakelijkheid in de financiële sector*, Deventer, Kluwer, 2013, 333 ff.

794 Idem.

795 Rb Amsterdam 28 January 2009, LJN BH5765 (X./ABN Amro); Rb Amsterdam 27 January 2010, LJN BL0909 (X./*Dexia Bank Nederland N.V.*); Hof s'-Hertogenbosch 10 March 2009, LJN BH5907, (*X./ Financieel Advies BV*); Hof 's-Hertogenbosch 22 June 2010, LJN BM9516, (*X./ABN Amro Bank NV*), available at: www.rechtspraak.nl. In these cases, the

had also already been applied in other cases than those related to the securities leasing litigation. In its decision of 11 November 2008 for instance, the ‘s-Hertogenbosch Court of appeal explicitly held that bank-defendant who acted as financial advisor violated its duty of care by advising a risky and complicated investment product without duly warning on the risks involved. Assessing transaction causation, the court holds that unless the bank succeeds in establishing proof of the contrary, the court assumes that the claimant would have chosen a different product to invest in.[796]

218. Another remarkable decision in this context is the decision issued by the ‘s-Hertogenbosch Court of Appeal.[797] The case was brought before court by an investor-claimant who sued the bank that had acted as his financial advisor and allegedly violated its duty to warn the investor-client regarding the risks related to intended investments. With regard to the establishment of transaction causation, the court explicitly refers to the landmark decision issued by the Dutch Supreme Court in the area of prospectus liability, in which the Dutch Supreme Court introduced a rebuttable presumption of causation founded on the obligation to provide for the effective enforcement of EU law, and particularly the Prospectus Directive.[798] In its appellate decision, the ‘s-Hertogenbosch Court of Appeal seems to consider the reasoning in the Supreme Court decision equally applicable in the context of investment services, though without explicitly saying so.[799, 800] None of the other reported decisions appears to have motivated the application of a presumption of causation via the jurisprudence on prospectus liability. Moreover, the argument to found a rebuttable presumption of causation on the principle of effective legal protection was explicitly turned down by the Amsterdam appellate court in a later decision.[801] In the scholarly literature, the potential implications of the reasoning of the Dutch Supreme Court in *World Online* and the transposition of the presumption in the context of investment services has received some attention as well. BUSCH and SILVERENTAND for instance point out that since MiFID also aims to enhance investor protection goals, the reasoning

court assumed causation between the established wrongful act, consisting of deficient information regarding the risks involved, and the claimed loss, being the remaining debt after portfolio liquidation. The court motivated its assumption of CSQN-causation by the uncertainty whether the investor-claimant would have acted differently had he been adequately informed and the lack of elements brought forward by the defendant suggesting the contrary. In a highly similar manner: Hof ‘s-Hertogenbosch 16 December 2008, *JOR* 2009/164.

796 Hof ‘s-Hertogenbosch 8 November 2011, LJN BU3873, (NBG Finance BV/van Uden), *JOR* 2012/111; other examples: Rb Amsterdam 2 March 2011, LJN BP7515, (Vestering Beheer BV/ABN Amro Bank NV), *JOR* 2011/147; Rb ‘s-Hertogenbosch 28 December 2011, (X./van Landschot Bankiers NV), *JOR* 2012/50; Rb Amsterdam 24 January 2007, *JOR* 2007/94, (Laan/Wijs & Van Oostveen BV), with ann. by F.M.A. ’T HART; Hof ’s-Hertogenbosch 14 September 2010, LJN BQ1192, (Grove/ van Landschot Bankiers NV), *JOR* 2011/116; Hof ‘s-Hertogenbosch 16 December 2008, *JOR* 2009/164; Rb Leeuwarden 25 October 2006, LJN BF6588, (Lawant te Paterswolde/ Achmea Pensioen- en Levensverzekeringen N.V.), *JOR* 2007/16, r.o. 8.

797 Hof ‘s-Hertogenbosch 22 June 2010, LJN BM9516, (*X./ABN Amro Bank NV*), available at: www.rechtspraak.nl.

798 HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht*, 2010, 21, with ann. by H.M. VLETTER-VAN DORT. See *infra*: para. 329.

799 More particularly, even though the Supreme Court clearly pointed out that the introduction of the presumption of causation was motivated by the need to render the investor protection measures issued in the Prospective Directive effective, the appellate court did not make a similar reasoning with respect to MiFID in this context. On the possibility to extend the rationale of the World Online decision to financial services, see also: BUSCH, 'Het 'civiel effect' van MiFID', 77; A.C.W. PIJLS and W.H. VAN BOOM, 'Handhaving prospectusaansprakelijkheid niet illusoir: vermoeden van causaal verband bij prospectusaansprakelijkheid', *WPNR* 2010, n° 6834, 199-200.

800 It should also be added that the Court of Appeal eventually concluded that in the present case the presumption was rebutted since the court did not consider it likely that the investor-claimant would have altered his strategy upon a bank warning. Since the investor-claimant was experienced and well-informed with respect to financial transactions and the risks involved, and had previously ignored warnings and advices, the court concluded it was not likely the warning would have had any effect (Hof ‘s-Hertogenbosch, 22 June 2010, LJN BM9516, (*X./ABN Amro Bank NV*), available at: www.rechtspraak.nl, r.o. 4.).

801 The court holds that following art. 150 Rv. no presumption can be applied: Hof Amsterdam, 31 January 2012, LJN BV7171, (X./ABN Amro Bank NV), *JOR* 2012/115, para. 3.22.

applied in World Online may equally prove relevant with regard to breaches of MiFID-based regulation.[802]

d. The application of lower evidential thresholds

219. Whereas the court decisions mentioned in the previous section show the reversal of the burden of proof as one way to deal with the evidential burden borne by the investor-claimants, in other instances the evidential problem was dealt with via a lowered evidential standard. For instance, in a recent decision of the Austrian Supreme Court, the latter considered that since no ultimate certainty is ever attainable in these circumstances anyway, an evidential standard of probability (preponderance) may suffice to prove a mere hypothetical course of events.[803] According to this standard of evidence, the claimant is required to bring forward allegations and evidence rendering causation more probable than not. Along somewhat similar lines, the (Dutch) lower court of Utrecht in 2008 stated that the burden of proof, which lies with the claimant, is in this kind of cases generally not applied in a very strict or onerous manner.[804] In other instances, courts have refrained from explicitly applying presumptions of causation, though reached a very similar outcome by promptly accepting causation even though solid evidence was hardly brought forward, or settled for a mere likelihood of causation.[805] Pursuant to a suit brought against ABN AMRO for unsuitable advice, the court assumed that the requirement of causation was satisfied since no convincing elements supporting the contrary had been brought forward.[806] Similarly, in a case brought before a lower court in which a financial

[802] BUSCH and SILVERENTAND, 'The Netherlands', 237, para. 7.152. See also: BUSCH, 'Why MiFID matters to private law', §6; BUSCH, 'Het 'civiel effect' van MiFID', 77; 295; BUSCH, 'MiFID II: Europese aansprakelijkheid van beleggingsondernemingen', 57-58. Similar: PIJLS and VAN BOOM, 'Handhaving prospectusaansprakelijkheid', 199-200. *Contra:* Hof Amsterdam, 31 January 2012, LJN BV7171, (X./ABN Amro Bank NV), *JOR* 2012/115; see on the impact of het EU effectiveness principle in the context of MiFID also supra, para. 102. See also: KRUITHOF, 'Privaatrechtelijke werking', 305; and TISON, 'Civil law effects', 2621-2639.

[803] OGH, 28 January 2011, 6 Ob 231/10d, available at: http://www.ris.bka.gv.at. See on this decision also: KÖCK, 'Liability for unsuitable Advice', 464.

[804] Rb Utrecht, 20 February 2008, LJN BC4542, (*X./DEFAM Financieringen B.V., AMASKA B.V., Fortis Bank (Nederland) N.V.*). See with regard lower evidential thresholds also: PIJLS, 'Informatieverzuimen', 170. The reference to the rather lenient approach to causation in this type of cases appears to refer to the securities leasing controversy. Albeit the Dutch Supreme Court had not yet delivered its decision on the case, lower courts had already been confronted with a mass of claims concerning securities leasing constructions. In several of those decisions, facilitations in terms of lower thresholds or presumptions had been employed in favor of the claimant-investors.

[805] (The Netherlands) In a decision by the 's-Hertogenbosch court of first instance for instance, the court held that after having been warned on the risks by a professional advisor, the likely course of action for the claimant-investor would have been to choose another investment. Hence, the court considered that causation was proven. Rb s-Hertogenbosch, 21 December 2012, LJN BU8810, available at www.zoeken.rechtspraak.nl, r.o. 4.20. Austria: in a rather recent decision, the Austrian Supreme Court relaxed the burden of proof for the investor-claimant. The court held that an investor can satisfy the evidential requirements by advancing facts and allegations that render the causal link between the wrong and the investment decision plausible. It is then left to the defendant to establish evidence indicating that the claimant's assertions are not plausible or probable. See: OGH, 28 January 2011, 6 Ob 231/10d, available at: http://www.ris.bka.gv.at. See on this decision also: KÖCK, 'Liability for unsuitable Advice', 464.

[806] Rb Amsterdam, 28 January 2009, LJN BH5765 (X./ABN Amro). The court found that the bank-defendant had neglected its obligation to examine the claimant-investor's profile and had provided the client with an investment strategy too offensive relatively to his profile. In addition, the bank did not adhere to the plan drawn up and agreed to by the client either. Similar: Rb Dordrecht, 31 January 2007, LJN AZ8212, (*X.*/ABN AMRO Bank N.V.): since no client profile had been recorded, the court found that the bank-defendant had violated its know your customer-obligation, and easily accepted causation between the breach and the claimed loss. Reference can also be made to the Belgian Confederation Life case, in which a bank had negligently omitted the subordinated character of the bonds recommended to the (conservative) retail investors, and additionally, failed to provide the investors with a correct rating. Reliance was easily and without much explanation accepted vis-à-vis these investors (Kh. Brussel, 26 March 1997, *Bank. Fin.* 1997, afl. 5, 334-340). In a similar manner, the Court of Appeal of Leeuwarden accepted reliance even though the alleged aggrieved investor did not even claim he would have relied on the warnings had they been given by the bank. The Court of Appeal particularly found that the bank-defendant – who failed to inform the investor-claimant of the risks involved in the investment strategy – correctly objected that the Court of First Instance had failed to answer the defendant's objections on the topic of causation in its decision. Secondly, it was stated

adviser operated without the required permit, the court considered the causal connection established, even though no objective elements had been brought forward.[807] The same goes for several French decisions in which the causal connection between the dishonest and/or incomplete information and the damages claimed was not closely examined but got accepted without further ado.[808] Although these decisions do not apply presumptions, the approach and outcome are very similar in effect.

e. *Conclusion and assessment*

220. The evidential problems relating to transaction causation in the area of defective investment services are broadly acknowledged in various Member States, as the preceding paragraphs demonstrate. Yet whereas the German courts and the Belgian legislator have provided for a conclusive solution by means of a presumption of transaction causation, the Dutch case law remains unsettled, although numerous examples show a tendency to show leniency and flexibility, both in the lower courts and at the level of the Supreme Court when it comes to assessing transaction causation. Arguments against the introduction of a presumption of causation generally assert that the use of a presumption essentially shifts the problem to the defendant, since the latter is generally in no better position to produce proof of the absence of an element as uncertain and subjective as reliance. Taking into account however that the establishment of reliance is problematic and renders the rules of conduct often unenforceable if strictly applied, the application of a causal presumption is justified, especially since it does not cause excessive or unreasonable consequences when taking into account that investors are still required to establish a loss suffered as a result of the wrong.[809] Particularly with regard to unsophisticated, inexperienced retail investors, the use of a presumption of transaction causation does not appear very radical as a solution for the evidential problems these investors encounter. It seems rather logical to assume that these investors are particularly dependent on the advice, information and warnings given by a professional investment service provider. Moreover, even in jurisdictions that have rejected the application of causal presumptions, the latter line of reasoning concerning unsophisticated retail investors is mirrored in the case law, which seems to take a more

that the investor-claimant did not provide evidence, and in fact not even alleged that he would have acted different had a warning been given by the bank, thereby failing to meet the burden of proof with regard to the required causal connection. These findings did not affect the outcome of the case thought of Appeal, for besides the failure to warn the client on the risks involved, the bank-defendant also violated the contractually agreed investment guidelines, resulting in losses for which the client-investor was granted compensation (Hof Leeuwarden 29 November 2011, LJN BU6235, *RF* 2012, 25; also available at: http://zoeken.rechtspraak.nl). See also: Rb Amsterdam, 24 January 2007, *JOR* 2007/94, (Laan/Wijs & Van Oostveen BV), with ann. by F.M.A. 'T HART. In this case, the court disregarded the requested application of the reversal rule as requested by the investor-claimant in examining the causal connection between the violation of the KYC-rules and the warning duty by simply stating that according to art. 150 Rv., causation could be considered established. Since the claimant-investor had admittedly stated that he was aware of the risks involved (at least to some degree) and had requested an offensive strategy himself, the decision is noteworthy. See also in France: CA Nîmes, 1st Ch., 16 June 2009, Jurisdata 2009-021512, (*Bergeron/Crédit Agricole Sud Rhône Alpes*). The latter decision was quashed by the French Supreme Court however for not applying the theory of the loss of a chance (Cass. 15 February 2011, comm., Jurisdata: 2011-001971, (*Crédit Agricole Sud Rhône Alpes/Bergeron)*, *Rev. Dr. Fin*., 2011, nr. 3, comm. 103 with ann. by J. DJOUDI*;* CA Paris, 8th Ch., 27 September 2007, Jurisdata 2007-356691, (*SA Caisse d'Epargne et de prévoyance Ile –de-France Paris/Zana*).

[807] Rb Arnhem, 16 April 2008, LJN BD1759, available at www.zoeken.rechtspraak.nl.

[808] Whereas the theory of the loss of a chance is often applied in this type of cases, (see *infra*, para. 232), the court awarded damages based on the initial investment to the claimant in these decisions instead. See: CA Paris, 8th Ch., 27 September 2007, Jurisdata 2007-356691, (*SA Caisse d'Epargne et de prévoyance Ile –de-France Paris/Zana*); Similar: CA Nîmes, 1st Ch., 16 June 2009, Jurisdata 2009-021512, (*Bergeron/Crédit Agricole Sud Rhône Alpes*). The latter decision was quashed by the French Supreme Court however for not applying the theory of the loss of a chance (Cass. 15 February 2011, comm., Jurisdata: 2011-001971, (*Crédit Agricole Sud Rhône Alpes/Bergeron),Rev. Dr. Fin*., 2011, nr. 3, comm. 103 with ann. by J. DJOUDI.

[809] VANDENDRIESSCHE, 'Causaliteit en bewijslast', 175-238 (215-217 in particular). See in this regard also: ROSAT, *Der Anlageschaden*, 154 (written from a Swiss perspective where a presumption similar to the German presumption is applied).

relaxed stance vis-à-vis these investors. For instance, in the UK the introduction of a causal presumption with regard to a victim's informed consent in cases other than medical liability was explicitly dismissed. It was held that the uncertainty regarding the causal connection in informed consent cases in the context of negligent financial advice does not allow for 'exceptional departures' from the long standing evidential principles in investment cases.[810] Yet considering the UK case law, relaxations towards retail investors can nonetheless be observed, as demonstrated in the next section.

2. The role of investor sophistication in the assessment of transaction causation

a. Investor classification in the case law

221. There is longstanding consensus in doctrine and jurisprudence that the scope of the duty of care imposed on investment firms depends on the sophistication and experience of the particular investor.[811] Besides its relevance for the scope of the duty of care, the degree of sophistication is however often also highly relevant in the courts' assessment of causation.[812] Courts tend to rule that

[810] *Beary v. Pall Mall Invests*, (2005) EWCA Civ 415; (2005) P.N.L.R. 35; see for a similar refusal to extent the presumption to other cases of professional advice (other than medical treatment cases), more particularly a case on negligent legal advice: *White v Paul Davidson & Taylor*, (2004) EWCA Civ 1511; (2005) P.N.L.R. 15. An underlying reason for this distinction between medical liability and claims based on negligent financial advice may be found in the traditional tort law reservation against the compensation of economic loss in the tort of negligence. See *supra*: para. 117.

[811] See particularly: KRUITHOF, 'A different approach', 154; A. MOREL and E. OMES, 'L'obligation d'information et de conseil du banquier', X., *Droit bancaire et financier au Luxembourg*, Vol. I, Bruxelles, Larcier, 2004, 483, 493; VAN SETTEN, *'The law of institutional investment management'*, 90, para. 3.45 and 3.47; BUSCH and SILVERENTAND, 'The Netherlands', 212-213, para. 7.62; K. FRIELINK, 'Banken, zorgplicht en optiehandel', *AV&S* 2004, nr. 3, 13; X. DIEUX and J.Q. DE CUYPER, 'Questions de responsabilité civile en matière de bancassurfinance', 187. See for instance with regard to France: Cass., 8 July 2003, jurisdata 2003-019876, (Vantrou/Banca commerciale italiana France); Cass. com., 5 November 1991, Jurisdata 1991-002781, (*Buon/BPBA*), *Banque et droit,* 1992, n° 23, 106, with ann. by J.-L. GUILLOT; *Bull. Joly Bourse,* 1993, 292, § 56, with ann. by F. PELTIER; Cass. com., 4 July 1995, *Bull. Joly Bourse* 1995, 497; Cass. com., 14 January 2003, *Banque et droit* 2003, n° 88, 33, with ann. by H. DE VAUPLANE and J.-J. DAIGRE; *Bull. Joly Bourse,* 2003, 254, § 44, with ann. by L. RUET; Cass. com., 8 July 2003, *Bull. Joly Bourse*, 2003, 595, § 76, with ann. by L. RUET. See also: H. DE VAUPLANE, 'La responsabilité civile des intermédiaires', *RD bancaire et bourse*, 1999, n° 76, November-December, 231; S. TORCK, 'Responsabilité Civile', *RD banc. fin.*, 2007, n° 1, Janvier, 44; see for Belgian examples: Rb. Dendermonde, 14 September 1992, *TBH* 1993, 1063 (holding that the investor-claimant, being a student in economics, could not be considered sophisticated or experienced enough because of his limited wealth and income, regardless of the fact that he had worked for an investment firm); Brussel, 23 March 2006, *TBH* 2008, nr. 1, 80-84, with ann. by B. CAULIER. The Netherlands: VAN BAALEN, *Zorgplichten*, 229 ff.. 427 ff.; for examples in the case law, see: Rb Amsterdam 27 April 2005, *JOR* 2005/154; HR 11 July 2003, LJN AF7419, (*X./ Coöperatieve Rabo-Bank Schaijk-Reek B.A.*), *JOR* 2003/199, with ann. by K. FRIELINK; *NJ* 2005, 103; Hof Leeuwarden, 4 December 2004, LJN AF1619, (*X./ Bank Bercoop N.V.*); Hof 's-Hertogenbosch, 6 November 2007, LJN BB7875, (*X./ Dexia Bank Nederland N.V.*), r.o. 4.13.4; all Dutch cases are available at: www.rechtspraak.nl; HR 17 December 2010, (Noordnederlands Effektenkantoor B.V./X.), *RvdW*, 2011, 14, also available at www.rechtspraak.nl, r.o. 4.4 in particular; HR 23 May 1997, (*Rabobank/Everaars*), *NJ* 1998, 192, with ann. by VAN ZEBEN; Luxembourg: '*investisseur averti'*, see for instance: Cass., 19 February 2009, n° 11/09, *ALJB – Bull. Droit & Banque*, 2009, n° 44, 53-54; also available at: http://www.justice.public.lu; Cass., 17 June 2010, n° 44/10, available at: http://www.justice.public.lu; Court of Appeal, 6 December 2007, n° 29.800, *A.L.J.B.-Bull. Droit & Banque*, 2008, n° 42,26; '*investisseur averti'* and '*profane'* see: Tribunal d'Arrondissement de Luxembourg siégeant en matière commerciale, 2 July 2008, n° 103485, *A.L.J.B. – Bulletin Droit & Banque*, 2009, n° 44, 48; Also: '*spéculateur d'habitude'*, see for instance: MOREL and OMES, 'L'obligation d'information', 496-497 and references to case law cited. Germany: BGH, 6 July 1993, XI ZR 12/93, *WM* 1993 1455; OLG Stuttgart, 4 March 2010, *WM* 2010, heft 25, 1170.

[812] See for instance: Belgium: Kh. Brussel, 27 April 1995 and 3 May 1996, *TBH* 1996, 1107-1115; Gent, 23 May 2002, unpublished, available at http://jure.juridat.just.fgov.be; Brussel, 23 March 2006, *TBH* 2008, nr. 1, 80-84, with ann. by B. CAULIER, 85-86. For an extensive discussion, see also: VANDENDRIESSCHE, 'Causaliteit en bewijslast', 195 ff. UK: Zaki v. Crédit Suisse, (2011), EWHC 2422 (Comm); Springwell Navigation Corp v JP Morgan Chase Bank (formerly Chase Manhattan Bank), (2010) EWCA Civ 1221; Peekay Intermark Ltd. v. Australia & New Zealand Banking Group Ltd, (2006) EWCA Civ 386; (2006) 2 Lloyd's Rep. 511 (CA (Civ Div)). See in this context also: A. TWIGGER, 'Sophisticated investors: do they have any rights?', 25 *JIBFL*, 2010, nr. 9 515; S. CLARKE and E. LAMBERTON, 'Collateral damage: a reference pool of CDO claims', 25 *JIBLR*, 2010, (7) (315) 320; C. BAND, 'Selling complex financial products to sophisticated clients: JP Morgan Chase v. Springwell: Part I', vol. 24 *Journal of International Banking Law and Regulation*, 2009, iss. 2, (71) 78; J.-P. CASTAGNINO, *Derivatives. The key principles*, New York, Oxford University Press, 2009 328, para. 8.120 ("The risk that a misrepresentation is made to a retail investor by a financial institution is more acute because of the greater reliance the retail

the less sophisticated the investor is, the more he can rely on the advice provided by a professional, and the easier reliance will be accepted.[813] This tendency has been observed in Belgian courts (in the period prior to the introduction of the statutory presumption of transaction causation), Italy, the Netherlands, and maybe most notably in the UK, where the matter of (producing evidence of) reliance has even been at the core of a number of claims pursuant to the distribution of complex products on a relatively broad scale.[814]

Even though most parties involved in this kind of litigation were professionals, such as banks and funds, their suits repeatedly referred to their lack of sophistication vis-à-vis the seller of the complex products, which had caused them to rely on the information (often referring to misleading or incomplete oral representations) provided by the seller.[815] With respect to professional and highly sophisticated investors though, the establishment of reliance proved much harder to establish before the courts.[816] For instance, whilst reliance was rejected with respect to a sophisticated, experienced dealer in emerging market products who purchased bonds[817] allegedly in reliance on the misleading and incomplete oral representations made by the defendant[818], an unsophisticated investor in a quite similar situation was yet successful.[819] Interestingly, the investor-claimants in both these cases had failed to read the documentation provided by the defendant, which contained clear, complete and correct information on the products. In both cases, the defendants argued that since the correct situation as well as the true nature of the investment was stated in the documentation, the investor had all necessary information at his disposal regardless of whether the oral representations were correct and complete. In *Peekay Intermark Ltd. v. Australia & New Zealand Banking Group Ltd,* the court concluded that since the investor-claimant was sophisticated and experienced, he relied on his own

consumer would reasonably place on the sales representatives of the financial institution"); VAN SETTEN, *'The law of institutional investment management'*, para. 3.45 and 3.47. The Netherlands: Gerecht van Eerste Aanleg van de Nederlandse Antillen, 10 Augustus 2009, LJN BJ5892, (X./Ennia Caribe Leven NV), *JOR* 2009/265; (reformed in appeal – Gemeenschappelijk Hof van Justitie v. d. Ned. Antillen en Aruba, 23 November 2010, (X./Ennia Caribe Leven NV), *JOR* 2011/50); See also: Hof Amsterdam, 2 November 2010, *JOR* 2011/80, (Prenger/ABN Amro NV). The relevance of the investor-claimant's sophistication is also discussed in: NEDERLOF-WOUTERS VAN DEN OUDENWEIJER and VAN DER WOUDE, 'Aspecten van aansprakelijkheid van de financieel adviseur', 222. Italy: PERRONE and VALENTE, 'Investor protection in Italy', 38. France: CA Toulouse, 20 March 2012, jurisdata 2012-005539, unpublished, (Pressenda/Soc. Banque Populaire Occitane).

[813] Idem.

[814] Consult the references in ftn. 812 and specificallly with regard to the UK also: Martin & Anor v. Britannia Life Ltd., (1999), WL 1706063; JP Morgan Bank v. Springwell Navigation Corp., (2008) EWHC 1186 (Comm) (QBD (Comm)); Bankers Trust International PLC v. PT Dharmala Sakti Sejahtera (No.2), (1996), C.L.C. 518; Cassa di Risparmio della Repubblica di San Marino SpA v. Barclays Bank Ltd, (2011) WL 674992. See also: BAND, 'Selling complex financial products to sophisticated clients: JP Morgan Chase v. Springwell: Part I', 71; E. GOODING, 'Selling investment products to sophisticated investors: reflections on Peekay v. ANZ', 21 *JIBLR* 2006, iss. 11, 628-633; CLARKE and LAMBERTON, 'Collateral damage', 315-329; C. BAND, 'Selling complex financial products to sophisticated clients: JP Morgan Chase v. Springwell: Part 2', 24 *JIBLR* 2009, iss. 5, 233-243

[815] Other issues, such as to what extent professional, sophisticated parties can include non-reliance clauses in their contracts, the scope and content of the duty of care related to advice and suitability of the products offered or recommended etc., were discussed in these cases as well.

[816] *Comp.*: Peekay Intermark Ltd. v. Australia & New Zealand Banking Group Ltd, (2006) EWCA Civ 386; (2006) 2 Lloyd's Rep. 511 (CA (Civ Div) and: Martin & Anor v. Britannia Life Ltd., (1999), WL 1706063**.**

[817] Generally referred to as GKO-bonds and issued by the Russian government. In this case, the investor wrongly thought that he was investing in the bonds, whereas the offer actually concerned a structured deposit linked to the performance of the bonds but without any interest in the underlying bonds as such.

[818] Peekay Intermark Ltd. v. Australia & New Zealand Banking Group Ltd, (2006) EWCA Civ 386; (2006) 2 Lloyd's Rep. 511 (CA (Civ Div). The court in first instance followed the claimant's reasoning and awarded damages, whereas the appellate court concluded that the investor-claimant had not been misled by the defendant. For an extensive and critical discussion: GOODING, 'Selling investment products', 632-633.

[819] Martin & Anor v. Britannia Life Ltd., (1999), WL 1706063. Two retail investors had allegedly been induced to enter into investments that outstretched their financial means and understanding. The investors were found to be innumerate nor sophisticated by the court.

assessment rather than to comply with what he had been told by the defendant.[820] In *Martin v. Britannia Life Ltd* on the other hand, it was decided that the fact that the investor-claimants had failed to read the accompanying documents demonstrated that they had completely relied upon their advisor and his recommendations.[821] In other words, whilst reliance on the flawed advice was rejected vis-à-vis a sophisticated investor who was found to have had a fair chance to be duly informed via the documents provided to him, the non-sophisticated investors were not held responsible in spite of not reading the accompanying documents. Moreover, the court considered the fact that the investor-claimants had failed to read the documents as an indication of their reliance on the faulty advice.

222. A similar point of view was expressed by the Brussels Court of Appeal assessing a claim for damages following a breach of margin requirements (dating from the period prior to the introduction of the statutory presumption of transaction causation).[822] The claimant particularly held that if the bank had demanded sufficient margin, as it is required to do, the claimant would have realized the risk and would have refrained from executing the intended speculative transactions. The court however considered that compliance with the margin requirements was unlikely to have made any difference since margin requirements are meant to warn the client-investor regarding the risks involved while the claimant-investor in this case was capable to understand and generally well aware of the risks (*'investisseur averti'*) regardless of any margin call.[823] In general wordings, the court held that in those cases where investors are not in need for more information to understand the nature of the investment and risks involved, the chain of causation between the breach to provide such information and the loss is interrupted ("*interruption du lien de causalité*").[824] Yet another illustration is offered by a decision handed down by the Amsterdam appellate court, in which causation was assessed in the light of the claimant's general education level and intellectual abilities as a heart surgeon and his past experience with investments.[825]

223. Summarized, depending on their level of proficiency, expertise, experience and knowledge, investors are subject to the principle of *caveat emptor*.[826] The assumption that only laypersons – as opposed to expert, experienced or professional investors – are considered in need of protection against their ignorance thus surfaces in the assessment of causation as well. The tendency to accept reliance more readily towards a non-sophisticated, non-experienced retail investor, than towards experienced

[820] For an extensive and critical discussion: GOODING, 'Selling investment products', 632-633.

[821] Martin & Anor v. Britannia Life Ltd., (1999), WL 1706063, at 7.2. Although the claimant-investors succeeded in establishing fault, loss and causation, they were not awarded any damages as the court found that their claims had passes certain statutory time limits and were hence statute-barred (r.o. 9.19).

[822] Brussel, 23 March 2006, *TBH* 2008, nr. 1, 80-84, with ann. by B. CAULIER, 85-86. For other examples with regad to the Belgian case law, see also: VANDENDRIESSCHE, 'Causaliteit en bewijslast', 195 ff.

[823] *Comp*. Kh. Brussel, 28 January 2011, *Bank. Fin. R.*, 2011/VI, 363, para. 19.

[824] Brussel, 23 March 2006, *TBH* 2008, nr. 1, 80-84, with ann. by B. CAULIER, 85-86. The court stated that the obligation to provide information to potential investors relates to the extent to which the investors need it. To the extent an investor is well aware of the nature of the investment and the risks involved, no additional information relating to those matters are needed. In these cases, the chain of causation is interrupted by the claimant himself, according to the court ("L'obligation d'information cesse là où le créancier d'information n'en a en réalité nul besoin parce qu'il a déjà connaissance de la teneur de l'opération qu'il envisage et des risques qu'elle comporte, parce qu'il est, en d'autres termes, un investisseur averti. […]Dans ce cas, le dommage subi par le client en raison des pertes occasionnées par l'opération résulte tout autant de sa témérité à s'y lancer. Il y a donc interruption du lien de causalité par son propre fait." p. 83).

[825] Hof Amsterdam, 2 November 2010, (Prenger/ABN Amro NV), *JOR* 2011/80, para. 4.8 in particular. With regard to the Netherlands, see also NEDERLOF-WOUTERS VAN DEN OUDENWEIJER and VAN DER WOUDE, 'Aspecten van aansprakelijkheid van de financieel adviseur', 222.

[826] For a similar conclusion and additional references to case law, consult: WYMEERSCH, Regulation and Case law relating to Financial Derivatives, 12.

knowledgeable or professional investors raises the question which criteria are considered relevant in the Member States' case law.

b. *Investor sophistication: concept and criteria*

224. The relevance of investor sophistication in the context of investor suits and the assessment of causation inevitably raises the question as to what standards or criteria apply to appraise (investor) sophistication.[827] Considering the available case law, however, no consistent and coherent pattern can be observed.[828] The aforementioned court decisions allow for the conclusion that experience with financial instruments on a professional level is considered highly relevant to determine the degree of sophistication of an investor. Other criteria taken into account include investment experience, the level of education and financial strength. For instance, to illustrate the importance attached to experience and knowledge, reference can be made to a lower court decision in Belgium where the court considered an investor sufficiently sophisticated because he had gained some experience with financial transactions over the years (although not on a professional basis) and set up an investment club.[829] In another case, the fact that the investor-claimants were considered 'intellectuals' was weighed in the assessment[830], while the fact that the investor had taken part in investment tournaments along with indications of speculative intentions and a good understanding of investment products was considered relevant in a decision by the Brussels appellate court.[831] Yet understanding or intelligence as such are not invariably sufficient to be considered sophisticated. In a court decision passed down by the Court of Appeal of Liège for instance, a student in economics, who also worked for an investment firm, was not considered sophisticated to carry out highly speculative transactions.[832] The court explicitly acknowledged that the student had effectuated similar orders when working for an investment firm and was familiar with investments and products as a result, yet it was concluded that the student was nonetheless not sufficiently sophisticated because he was lacking the necessary financial strength to engage in this kind of investments.[833]

The Luxembourg courts have distinguished between sophisticated investors ('*investisseur qualifié'*) and retail investors ('*investisseur amateur'*)[834] mostly based on considerations pertaining to the knowledge and experience in financial and banking matters, as well as the professional capacity of the investor.[835] The French Supreme Court on the other hand considered the specificity with which the

[827] Since a common terminology is lacking, the term 'sophistication' was chosen to indicate the level of expertise/experience/knowledge/proficiency etc. of the investor-claimant. The French distinguish 'inexperienced' ('*clients profanes'* and '*clients néophytes'*) and experienced investors, as well as 'informed' versus non-informed clients ('*clients (in)avertis'*), Belgian courts have used the term 'intellectual' as well as experienced and expert. The Dutch courts have used experienced and expert to distinguish. All these elements are covered by using the term 'sophisticated' in the following.

[828] *Comp*. KRUITHOF, 'A different approach', 158; V. COLAERT, 'Welke bescherming voor welke belegger? Cliëntenclassificatie pre- en post MiFID', *Bank. Fin. R.*, 2007, VI, 401, para. 10; see also in the same sense: PERRONE and VALENTE, 'Investor protection in Italy', 38.

[829] Rb. Dendermonde, 14 September 1992, *TBH* 1993, 1061-1062. Also discussed in: KRUITHOF, 'A different approach', 156-157.

[830] Gent, 4 April 2005, *TBBR* 2005, 535-539, with ann. by G. GATHEM, 539.

[831] Brussel, 23 March 2006, *TBH* 2008, 80. See also: COLAERT, 'Welke bescherming voor welke belegger?', 396; and VANDENDRIESSCHE, 'Causaliteit en bewijslast', 200.

[832] Liege, 16 January 1997, *TBH* 1999, 22-25.

[833] Idem, 24.

[834] MOREL and OMES, 'L'obligation d'information', 494. For instance: Tribunal d'arrondissement, Luxembourg, 28 October 2010, n° 128.041, *ALBJ – Bull. Droit & Banque*, 2011, 68-71.

[835] The sophisticated investors has been referred on an interchangeable basis as professional investor ('*investisseur professionel'*), informed investor ('*investisseur averti'*) and experienced speculator (('*spéculateur habitué*'). *Ibid.* 494 ff.

orders were passed, linked to the (considerable) order volume as an indication of the sophistication of the investors.[836] In a later decision, the French Supreme Court held that certain cumulative conditions – being (1) the professional competence, (2) the nature of the transactions and (3) the knowledge on financial instruments and the volume – were relevant in assessing the investor's level of sophistication.[837] However, since the French Supreme Court exercise very little control and supervision on the factual assessment of the investor's capacities and profile, it is generally left to the lower courts to evaluate.[838] The Dutch Supreme Court developed an approach according to which non-professional investors can hardly ever be considered sophisticated (*'deskundig'* or 'expert' in the court's terminology).[839] VAN BAALEN notices however that this line of jurisprudence is not entirely followed in the lower jurisprudence.[840]

c. Conclusion and outlook in the light of MiFID client categorization

225. Overall, these examples demonstrate a wide range of criteria employed to assess investor sophistication, including financial strength, age, education, professional status, investment experience and professional background. As these assessments are highly factual in nature, courts have a broad discretionary margin of appreciation, which has resulted in the application of a wide range of criteria that are not always given the same weight (with)in the Member States. Considering the client categorization system imposed by MiFID, it does not seem very likely that the latter will considerably effect or alter these observations when it comes to assessing whether and to which degree an investor was dependent on this advice and information in the light of his own sophistication, education, experience and the like, to make a particular investment decision. As COLAERT and KRUITHOF have pointed out, the MiFID client categorization system is likely to increase the awareness of investment firms with regard to the needs and protection required by the investor depending on his profile as a result of the need to determine investor profiles prior to providing the requested services.[841] The *ex ante* categorization of client-investors may therefore reduce disputes on whether and to what extent an investment firm had the duty to provide information or warnings, yet it does not affect the matter of whether and to what extent investors place reliance on information, warnings and advice. Second, the

[836] The court considered that the orders given by the investor-claimant were very precise and differentiated, which was considered an indication of the investor being a 'client averti', or a well-informed client. Cass., 1st Civ., 13 Octobre 1998, jurisdata 1998-003815, (Warin/Caisse Regionale de Crédit Agricole Mutuel du Pas-de-Calais), *Banque et Droit*, 1999, n° 63, 35, with ann. by H. DE VAUPLANE. See on this topic also: DE VAUPLANE, 'La responsabilité civile des intermédiaires', 231.

[837] "[…] la compétence professionnelle, la nature des opérations réalisées et la connaissance des instruments financiers et le volume des opérations"; Cass., Comm., 18 February 2004, jurisdata 2004-022555, (*Tumbarello/Société Oddo*). See also Cour d'appel Paris, 10 May 2012, Jurisdata 2012-011407, (S.A. Caisse d'Epargne et de Prevoyance Ile de France/Forlini), in which i twas held by the appellate court that the income and level of education are not sufficient to determine the level of sophistication of an investor. The investor's prior experience with financial transactions and particulalry speculative transactions instead prove more indicative of their knowledge and understanding of financial transactions and the risks involved ("[…], les investisseurs ne peuvent être qualifiés de profanes du seul fait de leur niveau d'étude et de leurs salaries qui ne sont pas des critères pertinents pour déterminer leur connaissance du marché boursier").

[838] R. BONHOMME, 'Responsabilité et gestion du risque financier', *RD banc. fin.*, 2010, n° 6, étude 31. However, decision of the Metz appellate court holding that an investor was familiar with financial markets, including highly speculative transactions, based on his profession of accountant was quashed by the French Supreme Court as improperly motivated. See: Cass., 15 September 2009, jurisdata 2009-049506, (Meyer/Caisse d'épargne et de prévoyance de Lorraine Nord). In another decision, the French Supreme Court held that the written documentation evidences that the investor-claimant was genuinely knowledgeable about financial markets and had built up experience over a long period of time. Cass., 8 July 2003, jurisdata 2003-019876, (Vantrou/Banca commerciale italiana France).

[839] The terminology used by the Dutch Supreme Court is 'deskundig', which can be translated as 'proficient' or 'expert'. See extensively: VAN BAALEN, *Zorgplichten*, 427-428 and references cited.

[840] *Ibid.*, 429-434.

[841] KRUITHOF, 'A different approach', 158; COLAERT, 'Welke bescherming voor welke belegger?', 422.

MiFID classification system divides investors into a group of professional and non-professional investors without adding further distinctions in the latter large and often quite heterogonous group of investors.[842] Since this group of non-professional investors is likely to include investors with considerably different profiles as a result, courts will continue to weigh various criteria and indications to assess a client's sophistication and add refinements and nuances at their own discretion to determine whether or not a particular investor would or would not have relied on the advice, warning, information that has been omitted or misrepresented. In line with what COLAERT and NEDERLOF-WOUTERS have asserted, the relevance of investor sophistication is thus likely to shift (even more) towards the assessment of transaction causation in terms of the degree to which an investor was dependent on the information, advice and warnings provided by professional investment firms and whether a different course of action would have been taken in absence of the breach.[843] In those legal systems where presumptions of causation have been introduced, the relevance of investor sophistication to assess transaction causation is considerably reduced, however.[844]

C. Proportional liability: the doctrine of the loss of a chance and its Dutch equivalent

1. Concept: modification of the traditional concepts of loss or causation

226. Modified concept of recoverable loss/causation. – The techniques and approaches discussed in the previous section, such as presumptions and the lowering of evidential thresholds, are considered in line with the traditional concept of causation because these approaches modify the evidential or procedural requirements, yet do not alter the concept as such, according to which causation between a breach and an alleged loss is either accepted or rejected in its entirety (all or nothing approach). Different from these traditional techniques, proportional liability and the doctrine of the loss of a chance explicitly acknowledge the uncertainty related to the establishment of (transaction) causation and approach this problem of causal uncertainty not by means of evidential facilitations, but instead by altering the concept of causation and harm.[845] More particularly, whereas an allegedly aggrieved investor is required to establish transaction causation between the wrong and the fact that he took a given investment decision in the traditional approach, an investor is required to establish causation between the wrong and the fact that he lost a chance to make a different investment decision under the loss of a chance doctrine. The recoverable loss is not the money lost or missed out on had a better investment decision been made, but instead the chance that has been lost to make a better investment decision which would have led to a better investment result. This is at least the theory under the loss of a chance-doctrine. Under the proportional liability doctrine as developed in the Netherlands, it is not the traditional concept of loss that is altered, but instead the concept of causation.[846] According to the

[842] COLAERT, 'Welke bescherming voor welke belegger?', 422.

[843] *Ibid.* 422; NEDERLOF-WOUTERS VAN DEN OUDENWEIJER and VAN DER WOUDE, 'Aspecten van aansprakelijkheid van de financieel adviseur', 222. See also: VANDENDRIESSCHE, 'Causaliteit en bewijslast', 201.

[844] Only in those cases where defendants attempt to rebut the presumption based on allegation that the client-investor would not have altered his decision absent the breach, the character and sophistication level of investors seems to bear relevance.

[845] See in this regard also: Klaassen, 'Bewijs van causaal verband', 160; A.G. CASTERMANS and P.W. DEN HOLLANDER, 'Omgaan met onzekerheid', *NTBR*, 2013, 185; A.J. AKKERMANS and C.H. VAN DIJK, 'Proportionele Aansprakelijkheid, omkeringsregel, bewijslastverlichting en eigen schuld: een inventarisatie van de stand van zaken', *AV&S* 2012, nr. 5, 157-177; C.M.J. KLAASSEN, 'Kroniek causaliteit in het aansprakelijkheidsrecht', *AV&S* 2012, nr. 5, 182-193; C.M.J. KLAASSEN, 'Kansschade en proportionele aansprakelijkheid: volgens de Hoge Raad geen zijden van dezelfde medaille', *AV&S* 2013, afl. 4; C.H. VAN DIJK, 'Causale perikelen: het is moeilijk en zal moeilijk blijven', 3 *TVP* 2013, 61.

[846] The distinction between proportional liability and loss of a chance seems rather dogmatic and theoretical, yet the Dutch Supreme Court has ruled that there is a difference between both doctrines in its decision handed down on 21 December 2012 (HR, 21 December 2012, LJN BX7491, (Deloitte Belastingadviseurs/H&H Beheer) *JOR* 2013/93). Even though A.-G. SPIER

Dutch proportional liability doctrine, the loss as it has been suffered is still the recoverable loss, yet it will only be considered recoverable to the degree that it is probably suffered as a result of the wrong.

227. Although it seems clear that both doctrines are highly intertwined, the Dutch Supreme Court stressed that the theories should be distinguished.[847] One reason why the distinction may bear importance, as indicated by the Dutch Court itself, is the fact that whilst the court has ruled at previous occasions that the doctrine of proportional liability should be applied with restraint and caution since it is based on causal uncertainty.[848] More particularly, imposing civil liability on wrongdoers in cases where the causal relation between the wrong and the loss suffered by the victim is uncertain, calls for a cautious approach, according the court. In case the doctrine of the loss of a chance is applied however, there is no question of causal uncertainty and, as a result, no reason to apply restrain.[849] The latter doctrines do not concern a matter of uncertain causation, but instead involves the assessment of the pecuniary value of the lost chance, which is a matter of the calculation of damages. This distinction and varying degrees of restraint in applying the doctrines seems very artificial however. In line with the conclusion written by the Advocate-General in this case, we agree that there may be a dogmatic difference in the conceptualization of both theories, yet as this difference a pure theoretical one that is rarely and hardly relevant in practice, it does not justify the different treatment of the theories by setting higher standards for one but not for the other. The next paragraphs discusses the doctrine of loss of chance and its Dutch variant, the proportional liability doctrine in the light of its employment in the context of losses allegedly suffered as a result of defective investment services.

2. The Dutch doctrine of proportional liability

228. The foundations of the doctrine of proportional liability as it exists today were laid by the Dutch Supreme Court in an asbestos case.[850] Summarized, the case dealt with a claim filed by the family of a former employee of the defendant who died of lung cancer. Since the employer-defendant had failed to comply with certain protective measures against asbestos during the time the employee had worked for him, the claimants deemed the employer responsible. As the exact cause of the lung cancer proved impossible to identify amongst several plausible possibilities[851], the Dutch Supreme Court explicitly recognized that the causal connection between the wrongful behavior and the claimed losses was impossible to establish. Hence, the court decided to award damages to the claimants

argued in favor of an ‘amalgation’of the loss of a chance doctrine and the proportional liability doctrine in his conclusion, the Dutch Supreme Court explained that there are differences between both doctrines that should be respected.

[847] HR, 21 December 2012, LJN BX7491, (Deloitte Belastingadviseurs/H&H Beheer) *JOR* 2013/93.

[848] HR 24 December 2010, LJN BO1799, (Fortis Bank (Nederland) N.V./ Bourgonje), *JOR* 2011/54; *NJ* 2011, 251; *NJ*B 2011, 110. See for a comment on this case also: BUSCH, 'Het 'civiel effect' van MiFID', 75, para. 33; G.J. BRUGMAN and W.M. SCHONEWILLE, 'Onzekerheid schadeoorzaak voor rekening belegger', *Bb* 2011, nr. 97-9.

[849] “Daarbij kan nog opgemerkt worden dat, nu het hof het condicio-sine-qua-non-verband tussen de normschending van [eiser 1] en het verlies van de kans van [verweerder 1] op een gunstiger fiscale behandeling heeft vastgesteld volgens de gewone bewijsregels, zonder in dat verband een proportionele benadering te hanteren, geen grond bestaat voor de terughoudende benadering die - in geval van causaliteitsonzekerheid - volgens het arrest Fortis/[B] bij toepassing van proportionele aansprakelijkheid op haar plaats is.” HR 21 December 2012, LJN BX7491, (Deloitte Belastingadviseurs/H&H Beheer) *JOR* 2013/93, r.o. 3.7

[850] HR 31 March 2006, LJN AU6092, (Nefalit/Keramus), *NJ* 2011, 250; *RvdW* 2006, 328; also available at: www.rechtspraak.nl. (Particularly r.o. 3.13). See on this case also: C.M.J. KLAASSEN, 'Proportionele Aansprakelijkheid: een goede of kwade kans?’, *NJ*, 2007, 1346-1362; B.C.J. VAN VELTHOVEN and P.W. VAN WIJCK, 'Proportionele aansprakelijkheid vanuit ex ante perspectief', *AV&S* 2008, nr. 20, 130-140.

[851] Not only is the cause of lung cancer generally very hard to track due to potential alternative causes such as genetic predisposition for instance, the matter was even further complicated in this case because the former employee had also been known to have smoked for at least 28 years.

relative to the degree of probability that the cancer had been the consequence of the prolonged exposure to asbestos while working for the defendant.[852]

229. In general terms, the court held that it must be assessed to what extent the defendant's behavior caused the damage. In case it is very likely that the defendant indeed caused the damage, liability must be considered established. In case it is not likely at all, liability should be rejected. When courts however end up in the gray zone in between, it would be unfair and unjust to shift the whole of the damage to the defendant as it is considered equally unfair and unjust to leave the claimants without any recovery. Hence, in these cases causation should be considered established though only to the extent it is probable that the wrongful act caused the damage. This implies that the damages must be lowered according to the probability that alternative causes might have caused the loss.[853] Taking into account that the application of this doctrine implies that a defendant may be held liable for damages that are not the result of his behavior or actions, the court stressed that the doctrine is to be applied with caution and restraint.[854] The doctrine should moreover be limited to those cases in which the objective of the violated rules and the nature of the damage justify its application.[855] Immediately after this court decision was issued, questions were raised with regard to the applicability of the theory of proportional liability (as it was referred to in literature) in areas other than employers' liability in health cases. Unsurprisingly, the question also arose whether the proportional liability theory might be applied as a solution to causal difficulties in the context of financial services liability too, especially since lower courts had already started to apply the doctrine in the context of investor suits.[856]

230. Application of proportional liability to financial services liability claims. – Even though the Dutch Supreme Court steadily broadened the scope of the proportional liability theory, it took a rather restrained and reserved position with regard to its application in the area of financial services. In a recent decision concerning a claim brought for defective investment services, the Supreme Court put strong emphasis on the need to employ the doctrine of proportional liability with due restraint and caution and consequently reversed an appellate decision in which the doctrine had been applied.[857] The case concerned an investor-claimant who had sold his company and intended to invest the proceeds of the sale on a long term basis. Since the sale of the company was executed through an exchange of shares, the proceeds of the sale consisted of shares in the acquiring company (Predictive Systems).[858] Due to lock up obligations imposed by US law, the investor was obliged to hold on the Predictive -

[852] The chance that the lung cancer was indeed caused by the smoking habit was determined by measuring the percentage of lung cancer patients amongst people known to have smoked for a similar period of time. For a more extensive explanation of how this was calculated, consult the decision (HR 31 March 2006, LJN AU6092, (Nefalit/…), *NJ* 2011, 250; *RvdW* 2006, 328; or: VAN VELTHOVEN and VAN WIJCK, 'Proportionele aansprakelijkheid', 130.

[853] The Court finds support for its reasoning in the combination of art. 6:98 DCC and 6:101 DCC. See for an application in the context of investor losses: KCHB, 12 February 2000, n° 1, available at: www.dsi.nl. See in this regard also: J.M. EMAUS and A.L.M. KEIRSE, 'Proportionele aansprakelijkheid en veroorzakingswaarschijnlijkheid', *MvV* 2013, nr. 5129.

[854] HR 31 March 2006, LJN AU6092, (Nefalit/Karamus), *NJ* 2011, 250; *RvdW* 2006, 328, r.o. 3.13.

[855] Idem.

[856] Rb Leeuwarden, 23 October 2007, LJN BB6528, (X./Aegon Financiële Diensten BV), available at: www.rechtspraak.nl; and three cases decided by the court of Amsterdam on 27 April 2007 against Dexia Bank Nederland N.V.: Rb Amsterdam, 27 April 2007, LJN BA3914, *JOR* 2007/151; BA3916, *JOR* 2007/152; LJN BA3920, *JOR* 2007/153. See for a discussion on why the proportional liability doctrine might be less suitable to solve the securities leasing issue: SCHILD, 'Condicio sine qua non'-verband', 260-261.

[857] HR 24 December 2010, LJN BO1799, (Fortis Bank (Nederland) N.V./ Bourgonje), *JOR* 2011/54; *NJ* 2011, 251; *NJ*B 2011, 110. See for a comment on this case also: BUSCH, 'Het 'civiel effect' van MiFID', 75, para. 33; BRUGMAN and SCHONEWILLE, 'Onzekerheid schadeoorzaak voor rekening belegger', 7-9.

[858] The value of the investment initially amounted to €63 million in shares in an American company (Predictive Systems) and about €10 million of other assets.

shares for a certain period of time. However, after the lock up period had expired and despite the fact that the price of the Predictive -shares had continuously fallen, the investor-claimant retained his participation. As the shares had lost considerably in value over time, the investor-claimant eventually sued the bank, asserting that the bank had failed to comply with its duty to adequately inform and warn him for the risks relating to the delayed sale.[859] The claimant contended that had he been duly informed and warned for the risk, he would have sold earlier to avoid (further) losses. The bank on the other hand raised that the investor-claimant had repeatedly confirmed his confidence in Predictive Systems, and that as an insider, he had been informed about developments and strategies that would have a positive impact on the stock price, even after significant stock price declines had occurred. Given this strong belief in the future, the bank argued that it was implausible that a warning or advice would have made a difference. The appellate court invoked the doctrine of proportional liability to solve the uncertainty and assessed the chances of the investor claimant selling the shares after a warning around 50 percent, thereby reducing the total of the damages correspondingly to 50 percent.[860] The Supreme Court struck down the appellate decision, however, holding that the doctrine of proportional liability should be employed with restraint and only insofar exceptional circumstances justify its application.[861] The court supported its rejection by the (undisputed) finding that the investor had demonstrated a rather obstinate attitude and strong belief in his own opinion about the investment, causing the court to consider it highly unlikely that the investor would have changed his strategy had he been advised to do so.

231. Although the Dutch Supreme Court did not rule out the application of the doctrine of proportional liability on investor losses suffered pursuant to defective investment services, the emphasis on the required restraint with which the doctrine should be applied cannot be neglected and has caused the scholarly literature to doubt whether proportional liability may serve as a solution.[862] It is submitted that in the light of its most recent decisions on investor suits, the Supreme Court seems inclined to employ a presumption of (transaction) causation or a fairly low evidential threshold with similar results, rather than applying the proportional liability doctrine.[863]

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[859] The share price fell, going from $40 per share at the end of the lock up period till $2 a piece at the moment of filing, the investor-claimant filed suit complaining that the bank-defendant had failed to inform and warn him of the risk related to a delayed sale of the Predictive shares.

[860] Hof Amsterdam, 4 April 2008, *JOR* 2009/51, with ann. by J.A. VOERMAN (X./Fortis Bank Nederland N.V.). See on this case also: BUSCH and SILVERENTAND, 'The Netherlands', 234-235, para. 7.144.

[861] HR 24 December 2010, LJN BO1799, (Fortis Bank (Nederland) N.V./ Bourgonje), *JOR* 2011/54; *NJ* 2011, 251; *NJB* 2011, 110. See on this case also: *Ibid.* 234-235, para. 7.144.

[862] KLAASSEN, 'Bewijs van causaal verband', 152 ff. Similar: A.A. ETTEMA, *Ondernemingsrecht*, 2011, nr. 4, 167-170 (annotation by HR 24 December 2010, LJN BO1799, (*Fortis Bank (Nederland) N.V./ Bourgonje*). See however KCHB, 12 February 2000, n° 1, available at: www.dsi.nl., for an application of the theory in the context of losses suffered following defective investment services. In favor of the proportional approach in investor suits: PIJLS, 'Informatieverzuimen', 170.

[863] See with regard to the low threshold – which can be considered very close to a presumption in effect – the decision issued in *Coöperatieve Rabobank Vaart En Vecht U.A./X.*: HR, 3 February 2012, LJN BU4914, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), *JOR* 2012/116, with ann. by S.B. VAN BAALEN; *Ondernemingsrecht*, 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; with ann. by D. BUSCH, *AA* 2012, 752. See also the conclusion of AG Hammerstein in this regard. With regard to the use of presumptions, see the landmark case on prospectus liability discussed in a following chapter: HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); RvdW 2009, 1403; *Ondernemingsrecht*, 2010, 21, with ann. by H.M. VLETTER-VAN DORT; With regard to the presumption applied in the securities leasing litigation: HR 5 June 2009, LJN BH2822, (Stichting Gedupeerden Spaarconstructie/Aegon), *JOR* 2009/200 and *RvdW* 2009, 685; LJN BH2815, (X./ Dexia Bank Nederland N.V), *JOR* 2009/199 and *RvdW* 2009, 683; LJN BH2811, (Levob Bank N.V./X.), *RvdW* 2009, 684.

3. Loss of a chance

232. In France and elsewhere, including the Netherlands, the loss of a chance doctrine has been considered or applied as a solution to the difficulties investors encounter to establish transaction causation.[864] Instead of attempting to establish causation between the wrong and a particular investment decision, causation concerns the relation between the wrong and the chance to make a more suitable investment or choose a carefully advised investment strategy that would have led to a better outcome. For instance, assessing an investor complaint for unsuitable investment advice, causing the investor to consent with rather speculative investments in the technology sector, while being unaware of the risks involved.[865] Assessing the recoverable loss, the appellate court held that he investor had not been adequately informed on the risks and *might* have decided differently absent the wrong. Yet, the court also considered that the technology market held strong attraction to investors at that point in time, especially because technology investments had generated high yields at the time of the investment and only started to register considerable losses shortly thereafter.[866]. The investor thus lost a chance to achieve a better result, yet the elements and facts of the case indicated that the chance was distinctly low that the investor-claimant would have made a substantially different decision had he been duly warned on the risks. The court therefore awarded a rather low award of damages.[867] Other than the Dutch proportional liability doctrine that assesses the probability of causation, the magnitude of the chance that an investor would have acted differently is not considered relevant to assess causation under the doctrine of the loss of a chance. Even in case the probability on another outcome is

[864] *Cass.* Com., 10 December 1996, (*France Compensation Bourse/Chevalier*), *Bull. Joly Bourse*, March-April 1997, 205-207, with ann. by H. DE VAUPLANE, 209-212; *P.A.* 1997, n° 15; CA Paris, 15th Ch., 30 April 2009, Jurisdata 2009-004992, (Collomb/Société American Express Paris); CA Paris, 6th Ch., 28 April 2011, Jurisdata 2011-007552, (Ploux/Caisse Regionale de Credit Agricole mutuel d'Ile et Vilaine); CA Aix-en-Provence, 8th Ch., 9 June 2011, Jurisdata 2011-013095, (Perez Morelli/ Caisse Regionale de Credit AGRICOLE MUTUEL ALPES PROVENCE); CA Paris, 6th Ch., 28 April 2011, jurisdata 2011-007552, (*Ploux/Caisse Regionale de Crédit Agricole Mutuel d'Ile et Vilaine)*; CA Paris, 6th Ch., 24 November 2011, Jurisdata 2011-026400 , (Sociéte CRCAM de Paris et d'Ile de France/Boubli e.a.); CA Aix-en-Provence, 8th Ch., 28 October 2010, Jurisdata 2010-027769, (Pappini/SA Banque Postale); CA Paris, 6th Ch., 5 November 2010, Jurisdata 2010-025513, (Dif e.a./ Banque Privée Saint Dominique); CA Dijon, Ch. Civ., 3 February 2011, Jurisdata 2011-003386, (SA Banque Populaire Bourgogne Franche Comte/De Saint Pol); CA Paris, 15th Ch., 26 March 2009, Jurisdata 2009-004538, (X./Banque Neuflize OBC); CA Paris, 15th Ch., 23 June 2006, jurisdata 2006-306115, (Dettwiler/SARL AS omnium); Cass., com., 26 November 1996, (Locatelli/Cofibourse), *Bourse et Produits financiers*, 1997, Mars-Avril, 205-208, with ann. by H. DE VAUPLANE, 209-212; CA Versailles, 10 February, 2010, Jurisdata 2011-001873, (Morosinotto/La Caisse d'épargne d'Île de France); Cass., Com., 15 September 2009, *Banque et Droit*, 2009, n°128, 44 with ann. by J.-P. DE BONNET, B. DE SAINT MARS, J.-J. DAIGRE, H. DE VAULGRENAT; Cass., comm. 9 November 2010, Jurisdata 2010-020804, (Campan/Banque de gestion privée Indosuez); CA Paris, 15th Ch., 27 January 2005, jurisdata 2005-271353, (Lautredou/Finance Conseil); CA Paris, 15th Ch., 25 January 2008, JurisData 2008-358592, (*Pourcelot/Oddo*); CA Lyon, 6th Ch., 28 March 2012, jurisdata 2012-008352, (Moutton/Caisse D'Epargne et De Prévoyance Rhône-Alpes); CA Aix-en-Provence, 8th Ch., 5 April 2012, Jurisdata 2012-006842, (Bagritzky/SA Société Générale); CA Paris, 15th Ch., 9 December 2004, Jurisdata 2004-264162, (Garrigue/La Soc. Oddo & Cie Entreprise d'investissement). See also: S. TANDEAU DE MARSAC, *La responsabilité des conseils en gestion de patrimoine*, Paris, Lexis Nexis, 2006 126-127; A.-C. MULLER, 'Dernières décisions relatives à la responsabilité des professionnels', *RD banc. fin.*, 2010, n° 2, comm., 74; I. RIASSETTO, 'OPCVM monétaires et crise des "subprimes": responsabilité civile des acteurs', *RD banc. fin.*, 2011, n° 4, July150; BONHOMME, 'Responsabilité et gestion du risque financier', étude 31. Luxembourg: RIASSETTO and RICHARD, 'Luxembourg', (161) 188, para. 6.102. See also: BUSCH, 'Why MiFID matters to private law', 21-22. Belgium: VAN OEVELEN, 'Contractuele en buitencontractuele rechtsbescherming', 127-128; ROGER and SALMON, 'Réflexions relatives à la responsabilité contractuelle', 402, no. 55; JACQUEMIN, 'Focus sur certains mécanismes', 149.

[865] CA Paris, 15th Ch., 25 January 2008, Jurisdata 2008-358592, (*X./ Soc. Oddo & Co*). The decision has confirmed by the French Supreme Court (Cass., comm., 15 September 2009, Jurisdata 2009-049496, (*X./ Soc. Oddo & Co*)).

[866] CA Paris, 15th Ch., 25 January 2008, Jurisdata 2008-358592, (*X./ Soc. Oddo & Co*). The decision has confirmed by the French Supreme Court (Cass., comm., 15 September 2009, Jurisdata 2009-049496, (*X./ Soc. Oddo & Co*)).

[867] An amount of €15.000 was awarded whereas the damages claimed by the investor to compensate the loss of investment value amounted to € 294.338,29. For a similar decision, see: CA Paris, 15th Ch., 9 December 2004, Jurisdata 2004-264162, (Garrigue/La Soc. Oddo & Cie); CA Paris, 15th ch., 29 May 2008, Jurisdata 2008-366770, (*Leclerc/SA Banque Neuflize OBC*).

very low, the lost chances are recoverable. Yet, the probability that another outcome would have been reached, is nonetheless highly relevant with regard to the determination of the recoverable loss. Regardless of how the matter is approached however, via the concept of causation or the assessment of damages, the result is the same. [868] Hence, the difference between the loss of chance doctrine and the Dutch proportionality doctrine seem merely theoretical.[869]

D. Transaction causation: assessment and concluding remarks

233. The analysis shows that in each of the examined jurisdictions, courts and investors (have) struggle(d) with identical questions and difficulties with regard to the establishment of transaction causation and have come up with different solutions and approaches. For instance, Germany and Belgium have opted for a presumption of transaction causation, while French courts tend to employ the doctrine of the loss of a chance. UK courts on the other hand attach considerable weight to the degree of sophistication to assess transaction causation, while the Dutch Supreme Court and the lower courts are in the process of developing an approach of which the outlines are not entirely clear. The cases decided in the aftermath of the securities lease controversy seemed to evolve towards the application of a presumption of transaction causation, yet the outlines of a solid and consistently applied court practice to deal with these issues has not been developed so far.

234. While these solutions attempt to alleviate the evidential problem investors find themselves confronted with in court, it was also noted that each of the approaches and solutions discussed in this chapter has been criticized. Considering the application of a presumption of (transaction) causation for instance, some have argued that presumptions are a tool too blunt to approach the problem with the required nuance and refinements. Presumptions were also argued to merely shift the problem to the defendant, rather than actually addressing the problem of uncertainty at the core. The loss of a chance as applied in France, and to a lesser extent in the Netherlands and other jurisdictions, and the Dutch proportional liability doctrine offer an alternative for the 'all or nothing' result achieved under the traditional approaches, yet this solution has sparked criticism too.[870] Proportional liability/loss of a chance as a solution to the problem has drawn criticism for the arbitrariness with which the probability or chances on another result are assessed in court. With regard to the assessment of causation anchored on the court's evaluation of the investor's level of sophistication, objections relating to legal certainty, consistency and uniformity could undoubtedly be raised as courts seem to use a wide range of criteria to which importance is attached on a case by case-basis which may render the outcome of a particular case unpredictable and uncertain to some degree. Put differently, each of the aforementioned solutions can be criticized for its imperfection.

235. The employment of the various techniques and the criticism each of these techniques has stirred, raises the question as to what approach to transaction causation should be taken. The question

[868] See also: A. BURROWS, 'Uncertainty about uncertainty: damages for loss of a chance', 1 *JPIL* 2008, 42-43. BURROWS notes that considering loss of a chance in the causation stage as opposed to thinking of it as a manner to quantify the damages is generally not that relevant; see also: T. K. GRAZIANO, 'The "loss of a chance" in European Private Law. "All or nothing" or partial compensation in cases of uncertainty of causation', in L. TICHY (ed.), *Causation in law*, Prague, Rozkotová, E., 2007, 127-128. The majority seems to consider the loss of a chance theory rather a question of damage than causation. See for instance: KOZIOL in B. WINIGER, H. KOZIOL, B.A. KOCH and R. ZIMMERMANN (eds.), *Digest of European Tort Law*, Volume 1: Essential Cases on Natural Causation, Wien/New York, Springer, 2007, 590.

[869] *Supra*, para. 155.

[870] For a law and economics approach towards uncertain causation and the 'all or nothing'-approach versus proportional liability: S. SHAVELL, 'Uncertainty over causation and the determination of civil liability', 28 *J. L. & Econ.*, 1985, 587-610.

obviously involves a technical-legal component, but is the more interesting and compelling because of its implications from a policy perspective. The first and foremost concern that comes to mind touches the general and recurrent fear of legislators and courts to create evidential facilitations that would result in an overly claimant-friendly system, allowing investors to recover losses stemming from risks that should be borne by the investors (the 'floodgates of litigation'-argument).

Balanced against this floodgate argument however, is the effectiveness argument. More particularly, considering that a strict approach to transaction causation imposes an evidential burden on investors that is often too high to meet, calls into question whether the rules governing the provision of financial services and aimed at eliminating information asymmetries can be effective in result if evidential or procedural rules render these rules hardly enforceable by investors themselves. Moreover, considering the multitude and magnitude of several recent reported mis-selling cases involving retail investors, it may be argued that the extensive sets of rules lack in effect without sufficient enforcement mechanisms.[871] As it has become acknowledged over time, and particularly in the aftermath of the recent financial crisis, that too much reliance has been put on disclosure when it concerns retail investors, the attention of legislators on both the EU and national level has turned towards the role financial intermediaries play in the distribution of (complex) investment products.[872] Responses to this finding have led to additional regulation on the distribution of financial products, including product intervention[873], but also directed the attention towards more scrupulous (private and public) enforcement of these rules.[874] The tendency to facilitate investor claims fits in with this evolution to scrutinize the distribution channels more closely.[875]

236. Balancing the aforementioned arguments and interests at stake, it is asserted that a presumption of transaction causation is unlikely to allow for too much leniency vis-à-vis investors, causing the floodgates to open, whereas it may contribute to the overall effectiveness of the rules.

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871 The distribution of Lehman-backed structured products to retail investors has triggered investor litigation in various countries, such as Germany, Belgium, Spain and the UK. See in this regard: ALEXANDRIDOU, 'Lehman Brothers Financial Products', 202; MOLONEY, 'Consumers or Investors', 176; FSA, FSA takes action to help investors with Lehman-backed structured products, 2009, October 27, http://www.fsa.gov.uk/, (press release); R. ZEPEDA, 'Derivatives mis-selling by British Banks and the failed legacy of the FSA', *JIBLR*, 2013, iss. 6, 209. The UK has seen a recent mis-selling litigation discussed in: FERRAN, 'Regulatory lessons from the PPI Mis-selling scandal', 247 and concerning the sale of PPI (Payment Protection Insurance). Other more isolated mis-selling problems are mentioned too (FERRAN, 'Regulatory lessons from the PPI Mis-selling scandal', 250) and discussed in the scholarly literature: BAND, 'Selling complex financial products: Part 2 ', 233; M. RYAN and A. YONG, 'Springwell - are the English courts the venue of last resort for complex investor claims?', 24 *JIBLR*, 2009, iss. 1, 54; C. BAND, 'Selling complex financial products to sophisticated clients: JP Morgan Chase v. Springwell: Part I', 24 *JIBLR* 2009, iss. 2, 71. In the Dutch courts, the securities leasing triggered the emergence of mass litigation, while other mis-selling of (often complex) financial products to retail consumers has occurred too.

872 MOLONEY, 'Consumers or Investors', 184; R. STEENNOT, 'Precontractuele informatieverplichtingen als beschermingstechniek bij de bescherming van de zwakkere partij in het financieel recht', X., *La protection du consommateur en droit financier - Bescherming van de consument in het financieel recht*, Cahiers AEDBF/EVBFR - Belgium, vol. 25, Antwerpen, Intersentia, Anthemis, 2012, 119-122; See also: F.M.A. T'HART and E. DU PERRON, *De geïnformeerde consument*, Deventer, Kluwer, 2006 in particular 103-118 and 127-128.

873 See *supra*, Part I, Chapter I, para. 0.

874 See *supra*, Part I, Chapter I, para. 66. See also the sanctioning regime proposed with regard to art. 75 Proposed Directive MiFID II.

875 *Comp.*: PERRONE and VALENTE, 'Investor protection in Italy', 40. PERRONE and VALENTE argue in favor of a strategy focused on the distribution channels of financial products (referred to as 'protective gatekeeping model'). With regard to the EU level, MOLONEY notes that "The main thrust of the crisis-era reforms is on tightening investment firm responsibility and on *ex ante* and *ex post* product intervention – not on further responsibilising the investor through disclosure", MOLONEY, 'Consumers or Investors', 184. The discussion on how financial service providers should be regulated, including the reach and the role of private enforcement of those rules, has become the center of debate in the US as well. For an overview: A.B. LABY, 'Fiduciary obligations of broker-dealers and investment advisers', 55 *Vill. L. Rev.*, 2010, 701; A. GHARIBIAN, 'Extending fiduciary duties to broker-dealers: yes we can & yes we should', 17 *PIABA*, 2010, No. 3 235.

More particularly, the finding that a presumption of transaction causation will not allow for a too lenient investor compensation system follows from the fact that in this context, causation is a two-layered concept that consists of transaction and loss causation. The employment of a presumption of transaction causation allows for the elimination of the evidential hurdle with regard to the first prong of causation, yet it does not affect the second layer. More particularly, even though transaction causation may be (refutably) presumed, an investor is still required to present evidence of the loss suffered as a result of the wrong. Losses that would have been suffered in the alternative scenario in which no violation occurred and a more suitable investment would have been chosen, remain to be borne by the investor and cannot be shifted to the defendant.

Second, the analysis of the case law in this chapter allows for the conclusion that courts have repeatedly displayed more lenience and flexibility towards unsophisticated retail investors. For the latter group of investors, the installment of a formal and explicit presumption of transaction causation may not really change much, except for the fact that legal certainty would be enhanced. More particularly, as court decisions assessing an investor's sophistication were reached on a case by base-basis and displayed a lack of uniformity and consistency within the Member States as well as on a comparative scale, the question as to whether one is considered sophisticated is no longer relevant for the application of a presumption (or other evidential facilitations) and thus eliminates an element of uncertainty. Moreover, in case a mass claim involving a large group of claimants would be brought, a presumption may facilitate the court proceedings considerably, as the Dutch Supreme Court decision in the securities leasing controversy illustrated. Finally, in those cases where circumstantial evidence can be presented to support the claim that the investor did not rely on unsuitable advice, incomplete or otherwise misleading information or advice, the presumption may be rebutted.

In the light of these considerations, it can be concluded that a presumption of transaction causation, either installed by courts or legislators, is not too blunt as a tool to remedy the evidential problems related to transaction causation. The impact of a presumption of transaction causation is confined to the causal link between the wrong and the investment decision taken by the investor, yet does not affect the second prong of causation, i.e. loss causation, as investors are still required to present proof of the loss they suffered, based on a comparison with the alternative scenario in which no wrongful behavior occurred.

237. A final remark on the assessment of transaction causation reverts to the recent legislative proposals at the EU level concerning investor protection measures. As stressed in one of the chapters[876], recent legislative EU proposals have signaled the Commission's increased interest for private enforcement as a tool to ensure compliance with the rules and strengthen investor confidence. In this regard, the PRIPS-proposal is especially noteworthy since it also includes a remark on the burden of proof relating to the requirement of causation. Whereas the Commission proposes a reversal of the burden of proof with regard to the requirement of fault[877], it is simultaneously suggested to leave

[876] See *supra*, Part I, Chapter II, para. 66 ff.

[877] According to art. 11 of the proposal, the burden of proof with regard to the compliance of the information document with the relevant provisions in the regulation is on investment product manufacturer. See also consideration (17): "As retail investors in general do not have close insight as to the internal procedures of investment product manufacturers, a reversal of the burden of proof should be established. The product manufacturer would have to prove that the key information document was drawn up in compliance with this Regulation.", European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012/0169, 352 final, Brussels 3 July 2012, available at http://eur-lex.europa.eu.

the burden of proof relating to causation with the claimant.[878] How this would relate to the application or enactment of a presumption of transaction causation by national courts (e.g. Germany) or national legislators (e.g. Belgium) remains unclear.[879]

[878] "However, it would be for the retail investor to demonstrate that his loss has occurred due to the use of the information in the key information document because this matter falls within the direct personal sphere of the retail investor.", consideration (17), European Commission, proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012/0169, 352 final, Brussels, 3 July 2012, available at http://eur-lex.europa.eu.

[879] See in this regard also: VANDENDRIESSCHE, 'Causaliteit en bewijslast', 214-215.

CHAPTER II. THE CONCEPT AND ASSESSMENT OF RECOVERABLE LOSS IN INVESTORS SUITS CONCERNING DEFECTIVE INVESTMENT SERVICES

I. Compensation of investor loss: general principles

238. As set out one of the previous chapters, recoverable loss is generally defined as the negative difference between the situation in which wrongful behavior has been instituted on the one hand, and the hypothetical situation as it would have been without the occurrence of the aforementioned wrongful act on the other hand.[880] Although this may sound straightforward, various difficulties arise when putting the theory into practice. First of all, reported case law indicates that courts have encountered difficulties determining when the loss has been actually and certainly suffered, and related to that, at what point in time the reference date to assess the loss should be determined. Taken into account that markets are subject to rapid and significant change, the determination of the relevant point in time to measure the loss may have a considerable impact on the determination of its scope. Courts have struggled with the question whether and how to factor in price fluctuations to assess the recoverable loss. For instance, if an investor allegedly suffered loss as a result of unsuitable advice, the question has arisen whether recoverable loss is actually suffered as soon as losses have started recording (in comparison with the hypothetical alternative), or whether the loss is only actually and certainly suffered following the sale of those investments as some commentators and courts have asserted.[881]

Second, the comparison between actual situation in which the wrong occurred and the hypothetical situation in which no wrong occurred not only requires determining the actually and certainly suffered loss, but also requires the determination of the hypothetical situation and its outcome. In the context of investor losses, however, numerous other investment opportunities may constitute plausible alternatives with varying outcomes, which may further complicate the assessment of the recoverable loss. Finally, it should not be forgotten that the investor also bears responsibilities and is for instance required to carry out reasonable efforts to mitigate the loss, while negligence on the side of the investor may also have contributed to the emergence of the loss in the first place. Courts have resorted to concepts such as the mitigation of damages and the concept of causation to (re)allocate the risk by shifting it (back) to the investor when deemed justified.[882]

239. The assessment of recoverable investor loss may thus be complicated by various. Answers to these questions are to be found in the general principles of liability law, and should seek to strike a balance between adequate investor compensation while respecting that investors accepted the risks inherent to investment activities and bear responsibility for the implications of those risks, as is a generally accepted principle in all of the Member States' liability laws.[883] In the light of this overall goal of balancing the various interests at stake, it is consistently tried to align responsibility for losses

[880] See *supra* Part. I. Chapter III, para. 135.

[881] See further below, para. 245.

[882] VAN BAALEN, *Zorgplichten*, 418; BENICKE, *Wertpapiervermögensverwaltung*, 888-889; VAN LUYN and DU PERRON, *'Zorgplicht'*, 282; C. LOMBARDINI, *Droit bancaire suisse*, Basel, Genève, Zürich, Schulthess, 2008 799, para. 39-40. On the link between the migitation of losses and the setting of an appropriate reference date, see also: D. HUBBARD, 'Damages for breach of contract: the correct time for assessing loss', 26 *JIBFL* 2011, no. 1, 15.

[883] See *supra*, para. 145 and the references cited. See also the ECJ case law in this regard. For instance: Case C-215/08 *Friz GmbH* [2010] ECR I- 2947, para. 48-49. For the facts of this case, see *supra*, para. 0.

with the risk investors have willingly accepted to take, and the risks investment services should account for as a result of the breach.[884] Keeping these general principles in mind, the concept and measurement of recoverable investor losses due to defective investment services are analyzed in detail in this chapter. The chapter sets out with the first step in the determination of the recoverable loss according to the difference theory (‘*Differenzhypothese’*), being the assessment of the actually suffered loss following defective investment services. Consequently, the second step, being the determination of the hypothetical alternative, is discussed in detail. The latter also includes a discussion on the evidential techniques that may be employed. In a final section of this chapter, limits on recoverable losses imposed by the duty to mitigate the loss, contributory negligence and the netting of gains and losses stemming from breaches are discussed.

II. Actually and certainly suffered investor losses

A. Overview and illustrations

240. Appropriate reference date for investor losses. Difficulties. – The relevant point in time to assess damages is generally referred to as the reference date (‘*peildatum*’, ‘*date de* réference’, ‘*Stichtag*’). As a general rule, the scope of the loss is assessed at the moment the judicial decision is delivered[885], or alternatively, as is the case in Germany, the day of the last oral debates in court.[886] The moment of the judicial decision is generally considered the appropriate reference day because it allows the courts to take all relevant circumstances into account and provide recovery without under- or over-compensating the victim.[887] In case of contractual breaches, some jurisdictions allow the claimant to choose a reference date in the period between the occurrence of the breach and the delivery of the judicial decision.[888] Yet another option is the date on which the breach of contract or tort occurred[889], or as in UK law, damages can also be assessed at the date when the cause of action arose.[890]

Regardless of these general principles, however, courts have often used their discretionary powers to deviate and determine a more appropriate reference date in the light of the circumstances of individual cases.[891] More particularly, considering that the reference date is a rule in function of the overriding

[884] See also: VAN BAALEN, *Zorgplichten*, 419.

[885] Belgium: Cass., 26 January 2007, *RW* 2009-10, afl. 35, 1468; Brussel, 8 May 2008, *TBH* 2012, afl. 1, 30-33, with ann. by A. COIBION (25-29); RONSE, *Schade en schadeloosstelling*, 263, para 368. France: Cass., Ch. Civ., 21 Oct. 2009, Jurisdata: 2009-050153; Cass, Civ. 2th Ch., 21 March 1983, *Bull. Civ. II,* n° 88. See also from a Swiss point of view: CHAPPUIS, *Le moment du dommage*, 75, para. 157; ROSAT, *Der Anlageschaden*, 77; S. EMMENEGGER, 'Le devoir d'information du banquier', C. CHAPPUIS and B. WINIGER, *La responsabilité pour l'information fournie à titre professionel*, Zürich, Basel, Genf, 2009, (69) 84. UK: BURROWS, *Remedies*, 184. Germany: CASPER and ALTGEN, 'Germany', 125, para. 4.121. For a comparative overview including France and the UK, consult: CHAPPUIS, *Le moment du dommage*, 82, para. 69 ff.

[886] BGH, 28 October 1993, VII ZR 256/92, *NJW* 1994, 314; *BB* 1994, heft 7, 464; BGH, 13 March 1980, II ZR 176/79, *NJW* 1980, 1742; OLG Nürnberg, 24 November 2003, 8 U 36/03, available at: http://www.rws-verlag.de. See also: GEIBEL, *Der Kapitalanlegerschaden*, 138-139.

[887] RONSE, *Schade en schadeloosstelling*, 270, para 374; CHAPPUIS, *Le moment du dommage*, 75, para. 157; SPITZ, *La réparation*, 249, para. 407.

[888] With regard to Switzerland: EMMENEGGER, 'Le devoir d'information', 84.

[889] The Netherlands: BUSCH and SILVERENTAND, 'The Netherlands', para. 7.159; UK: MCGREGOR, *McGregor on damages*, 16-002; HUBBARD, 'Damages for breach of contract: the correct time for assessing loss', 15 and the references in the text (e.g. Miliangos v George Frank Ltd, (1976) AC 443, at 468). Switzerland: EMMENEGGER, 'Le devoir d'information', 84.

[890] Extensively on the topic: Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254; BURROWS, *Remedies*, 185 and references cited: Philips v. Ward, (1956), 1 WLR 471; Dodd Properties (Kent) v. Canterbury City Council, (1980) 1 WLR 433.

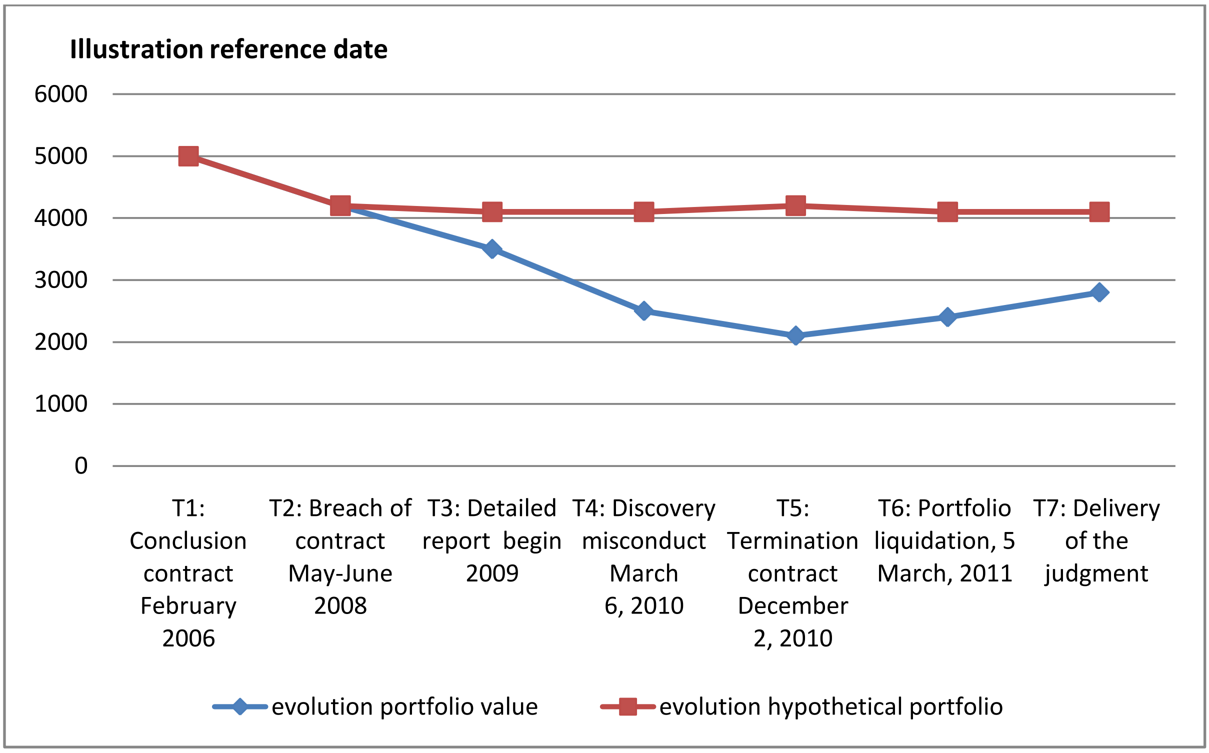
[891] See for instance UK: Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254; *Ibid.*, 186, stating that “the exceptions are such that it is now arguable that assessment at the date of loss no longer represents the general rule”. Switzerland: BGE,

compensatory principle, being that the victim should be put in the place where he would have been without the occurrence of the wrong, modifications to the general principle may occur.[892] The latter is especially relevant in the context of investor losses. The reference date marks the moment or day on which recoverable loss is measured, which implies that any changes occurring after this point in time are not taken into account. Since securities prices are variable and often incessantly subject to fluctuations, the determination of the reference day may have a considerable impact on the scope of the recoverable loss, and hence the damages to which an investor is entitled. As a result, courts have struggled with the fixation of the reference date in investor claims more than in many other areas. An example illustrating the above may clarify the nature and relevance of the matter more clearly.

241. Illustration. – Assume an investor contractually agrees to have his assets managed based on a conservative strategy by an asset manager in February 2006 (T1). The contract mentions that only a minor part of the portfolio is to be invested in shares (max. 30 percent) and a large majority in fixed income securities, such as bonds (70 percent). Suppose that after more than four years, the portfolio has lost half of its initial value. Taking a closer look at the investment portfolio and its composition, the investor-client realizes that the asset manager has disregarded the terms of the contract and has invested a considerable part of the portfolio (say 50 percent) in highly speculative shares. The fact that the asset manager breached the contract terms (T2) could have been discovered around the beginning of 2009 if the investor would have studied the reports that contained details on the performance and composition of the portfolio that were sent to the client-investor (T3). The latter however only discovers in March 2010 that something apparently went wrong when noticing the losses the portfolio was recording by then (T4). When expressing his concern regarding the composition and overall performance to the asset manager, the latter reassures the client-investor that recovery is almost certainly imminent and advises to wait for the situation to improve again. Since the value of the portfolio continues to fall however, the client-investor decides to terminate the contract at the end of 2010 (T5). After contacting a lawyer and at the same time noticing a slight recovery in the value of the portfolio, the client-investor decides not to take any chances anymore, liquidates the portfolio and files claim for damages (T6).

15 January 2008, 4A_351/2007, unpublished, with ann. by B. CHAPPUIS, 'L'évaluation du dommage face aux fluctuations de la bourse', *HAVE/REAS*, 2008, nr. 2141-145; Extensively on the topic: CHAPPUIS, *Le moment du dommage*, 100, para. 209 ff. See also: EMMENEGGER, 'Le devoir d'information', 184.

[892] See in this regard: HUBBARD, 'Damages for breach of contract: the correct time for assessing loss', 16, asserting that deviations from the breach date rule are justified whenever the overriding principle of compensation requires it, especially since the breach date rule is a function of that principle. ("The question, when is the correct time for assessing loss, is really subsumed within the more fundamental inquiry: what position would the innocent party have been in if the contract had been performed? In answering the latter question account can be taken not only of the probability of events occurring which were, at the date of breach, uncertain, but also of actual events subsequent to the breach." And: "In circumstances where, however, assessment of loss ate the date of breach would (for whatever reason) give the claimant more (or indeed less) than he would have received if the contract had been performed, then the breach date rule must yield to the overriding compensatory principle.").



Brought before the court, the question arises at what point in time the relevant reference day should be set. At the moment that the breach occurred (T2), the portfolio had a total value of €4.200, while at the earliest moment when the breach could have been detected) (T3), the investments in the portfolio had a value of around €3.500. The investor-client however failed to notice the breach at that time and realizes there is a problem no earlier than March 2010, when the portfolio has a total value of €2.500 (T4). Biding his time in accordance with the asset managers' advice, the portfolio continues to lose value and has a total value of €2.100 at the moment the contract is terminated (T5). In the months after the contract was terminated however, the value of the portfolio rose again to around €2.400 at the moment when the client decides to take no further risk and liquidates the portfolio (T6). At the moment when the court delivers its judgment, the portfolio would have been worth around €2.800 (T7). Assuming that the hypothetical alternative investment would not have fluctuated in an identical fashion but would have maintained a more stable evolution (between €4.200 and €4100), it matters to both parties at what point in time the loss is assessed. Whereas the wrongdoer would prefer the loss to be assessed at the moment when the breach could have been detected at the earlier (T3) or, alternatively, when the judgment was delivered (T7), the claimant will most likely argue that T5 or T6 are more appropriate since the scope of the loss, and hence the damages, are more favorable to the claimant in these latter cases.

242. Appropriate reference date for investor losses. Opportunistic investor behavior. – The illustration in the previous paragraph illustrates that various possibilities exist with regard to the determination of the reference date. As the reference date may impact the scope of the recoverable loss, investors and wrongdoers are likely to take different sides on the matter, and may even start to behave opportunistically. Consider for instance the facts of a case brought before the Schleswig *Oberlandesgericht* offers.[893] The case concerned a failure of the bank to execute a share sale order passed by a client-investor on a particular day. Had the bank correctly executed the order that day, the

[893] OLG Schleswig, 4 May 2000, 5 U 227/98, *ZIP* 2000, heft 39, 1721, with ann. by BALZER; *EWIR*, 2000, heft 16, 759.

shares would have been sold for 59 Deutsche Mark. Even though the order was limited to the particular day it had been issued, the bank disregarded the limitation and executed the order anyway the next trading day. The shares were sold for 64 Deutsche Mark per share (around €32 and for more than the initial order). Noting that the sale had gone through, despite the fact that no valid order to that end had been issued, the client-investor immediately contacted the bank and asked for the cancellation of the sale of the shares at the expense of the bank, which the latter refused almost one week after the request. The claimant filed claim for damages, yet as two stock splits took place during the court proceedings, one in July 1998 and another one in 1999, the amount of initial shares the investor held would have doubled after the first split (1:2) and multiplied again with 50 (1:50) after the second stock split in 1999, leaving the claimant with 5000.[894] At the moment of the last oral debates in court, which is the moment that is usually employed to assess the loss according to German law, the shares that were trading for €90/share loss (while initially 50 shares had been erroneously sold for around €32). Asserting that since the bank had wrongfully sold the shares, the claimant-investor demanded that the bank procures the shares (at its own expense) in return for the proceeds the claimant received for the wrongful sale of the 50 shares (at €32/share).

243. Considering this example, the rule to assess the loss at the day of the judgment (or at the last oral debates as is customary in Germany) is not expedient when considering the implications of such a rule. As BALZER critically notes in an annotation to the decision[895], allowing an investor to remain passive and formulate demands with the benefit of hindsight obviously leaves room for opportunistic behavior. As court proceedings may take several years, investors can hold out and adjust their claim according to (major) positive price fluctuations that may occur, while avoiding incurring any loss. This kind of allegations – being that the securities would have been sold at the highest possible price with hindsight – is obviously impossible to verify afterwards and offers a window to investors to exploit claims at the expense of the wrongdoer. Consider for instance a scenario in which the shares would not have increased in value during the court proceedings, but assume instead that the shares would have lost value at the moment of the oral debates and would trade for a price lower than the price the shares were erroneously sold for by the bank. In the latter hypothesis, investors are likely inclined to allege that they would have sold earlier, had they had the shares in their possession, and rather demand compensatory damages based on the price they would allegedly have sold at, instead of asking for the restitution of the shares (or reimbursement of their value as it stands at that point in time).

244. Considering the facts in the aforementioned case, the Schleswig *oberlandesgericht* stated that the bank had erroneously executed the order and must remedy the loss suffered as a result. The court (rightly) clarified however that this does not imply that the entire loss claimed by the investor, i.e. the price evolution as it had developed over more than a year) had to be compensated for. The court struggled to find a suitable solution to its problem and later saw its decision quashed by the German Supreme Court.[896] Considering the problem, the latter stated in rather general terms that the harmful behavior of both parties should be balanced against each other in order to apportion the loss in accordance with each contribution to the emergence and the scope of the loss. As this statement does

[894] The first split doubled the value of the shares as the split was 1:2. The year after however, a split of 1:50 was carried out. The shares basically gained one hundred times their worth following the stock split operations. The initial 50 shares of the investors that had been worth around 3.000 Deutsche Mark had increased to 320.000 Deutsche Mark in two years in other words. See for these numbers also: BALZER; *EWIR*, 2000, heft 16, 759.

[895] BALZER; *EWIR*, 2000, heft 16, 759.

[896] BGH, 24 July 2001, XI ZR 164/00, *ZIP* 2001, heft 37, 1624, with (critical) annotation by BALZER; *EWIR* 2001, heft 24, 1131, with ann. by HAMMEN; *WM* 2001, heft 36, 1716; also available at http://www.juris.bundesgerichtshof.de.

little more than restating the principle and purpose of liability and compensation (as outlined in the previous section), the next section investigates in more detail at what point in time recoverable investor losses for defective investment services should be assessed, and whether and to what extent price fluctuations may affect the fixation of the reference date. The analysis is based on the recurring principle that risks and responsibility for investment decisions should be aligned, or as the German Supreme Court put it, loss should be apportioned in accordance with each party's contribution to the emergence and aggravation of the loss. The next sections explore how to put these principles into practice.

B. Liquidation of investments: prerequisite for the compensation of investor loss?

1. Overview and outlines

245. Certain v virtual loss – In order to recover a loss, courts generally require that the loss is certain, in the sense that a loss must actually have been suffered or will be suffered in the future by the aggrieved party.[897] In the context of investor suits the question arises at what point in time the loss is considered sufficiently certain to be taken into consideration for the calculation of the damages, and more particularly whether a claimant-investor is required to sell the investment to 'fix' the loss. More particularly, according to some commentators and court decisions investor losses must be considered virtual as long as the claimant-investor is still in possession of the relevant securities.[898] Consider for instance the following example concerning a claim brought by an investor before the Paris appellate court.[899] The case concerned an asset manager who had rearranged the investor's investment portfolio on the latter's behalf employing a dynamic strategy, thereby violating the contractual agreement with the investor to administer a defensive investment strategy. Because the investor had not sold the disputed investments, the appellate court decided that sufficiently certain loss had been suffered and

[897] Belgium: SIMOENS, *Schade en Schadeloosstelling*, 51 ff. The Netherlands: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 16. UK: MCGREGOR, *McGregor on damages*, 325, para. 8-001 ff. For an overview see also: TREITEL, 'Remedies for breach', 83, para. 107. France: CA Paris, 15th Ch., 10 June 2005, Jurisdata 2005-279464, (S.A. Aurel Leven Securities/De Botton); PH. LE TOURNEAU and L. CADIET, *Droit de la responsabilité et des contrats*, Paris, Dalloz, 2002, 369, para. 1410 ff. and references cited. See also *supra*, para. 137 and ftn. 528 in particular.

[898] See: (Switzerland) LOMBARDINI, *Droit bancaire suisse*, 818 ff. para. 62 ff., and in particular para. 69, in the context of asset management; similar in: C. LOMBARDINI, 'Le dommage du client dans la gestion de fortune: un sujet complexe', *Relevant*, 2006, n° 4III.2; Germany: SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 42. *Comp.* in the context of issuer liability: V. MAGNIER, 'Information boursière et préjudice des investisseurs', *Rec. Dalloz*, 2008, no. 9558; The Netherlands: Rb Amsterdam, 12 January 2011, and 13 January 2010, *JOR* 2012/79, (X./Theo Gilissen Bankiers NV), particularly at 2.13.; K. FRIELINK, annotation of KCD 27 August 2002, 2002-152, *JOR* 2003/90, nr. 7. Belgium: Brussel, 30 June 2003, *Bank. Fin. R.*, 2004, nr. 3, 175, with ann. by V. DE VUYST, ''Beste uitvoering' (best execution) van beursorders: de zorgvuldigheidsnorm nader bekeken', *Bank. Fin. R.*, 2004, nr. 3, 177. The latter case requires further clarification with regard to the facts. In this case, the claimant-investor had ordered the sale of certain securities and demanded that the order would be processed quickly. The bank-defendant erred in waiting for the US stock exchange to open (which took several hours) instead of selling on a European market, as would have been the normal course of dealings. Due to the bank's behavior the orders were not executed that day, causing the claimant to file claim for the damage he allegedly incurred as a result. The claimant demanded redress including the loss of value since (1) the securities prices were down below ($8) the purchase price ($8,625) at the moment of filing the claim and (2) the loss of profit since the securities listed at $12,3 at the moment of the disputed order. The court refused to award damages for the depreciation of the securities below the purchase price for the claimant had not sold the securities and thus could still recover the initial investment. With regard to the foregone profit though, the court awarded a compensation equal to the difference between the purchase price and $12,3, the latter being the stock price at the moment the order was given. The court reasons that the profits are definitely gone, whereas recovery of the stock price up until the purchase price is still possible. In a highly similar sense: Austria: 28 January 2011, 6 Ob 231/10d, available at: http://www.ris.bka.gv.at. See on this decision also: KÖCK, 'Liability for unsuitable Advice', 461.

[899] CA Paris, 15th Ch., 10 June 2005, Jurisdata 2005-279464, (S.A. Aurel Leven Securities/De Botton), with ann. by H. DE VAUPLANE and J.-J. DAIGRE, *Banque & Droit*, 2006, n° 105, (33) 41-42. The decision in first instance was issued by the Tribunal de Grande Instance ('TGI') in Paris on 2 December 2003 (RG n° 200118662), but has not been published.

that the investor was not (yet) entitled to compensation as a result. The court considered that as long as the claimant remains in possession of the investment, the loss is considered merely hypothetical because of its continuous dependence on price fluctuations.[900] Along similar lines, some commentators have argued that the sale of the disputed investments or securities is indispensable as it offers a clear cut and indisputable reference date to assess the recoverable loss[901], while it also effectively forestalls potential speculative behavior on the side of the investor-claimant.[902] More particularly, it is asserted that awarding damages for the loss while simultaneously allowing the investor-claimant to remain in possession of the securities or portfolio offers the latter the possibility to await the potential recovery of the securities and therefore recover for loss he may never actually suffer.[903] Assume for instance an investor confronted with considerable losses in his investment portfolio allegedly due to the fact that the asset manager violated the terms of the contract by applying a far more aggressive strategy than agreed to. If this investor would be allowed to claim damages while keeping the portfolio, the portfolio may increase in value over time, while at the same time the investor may get compensation for the loss he claims to have suffered. According to some commentators and case law, this comes down to a chance to unjust enrichment (‘*Bereicherungs-chance*’).[904] Or put differently, opportunistic investors are likely to simultaneously claim for damages and preserve the disputed investment to exploit the chance on recovery. Since compensation awards and incites such behavior, it should be precluded by means of a prerequisite sale of the disputed instruments, according to these authors.[905]

246. Court decisions have indeed shown to struggle with the assessment of damages as a result of volatile price evolutions. Although the proposed solution by means of a prerequisite sale appeals as it seems to be a straightforward and plain solution to the problem at first glance, an analysis of reported case law across various Member States learns that the matter is not undisputed and that conflicting views exist on whether an investor should dispose of the investment in order to be able to obtain redress.[906] Analyzing the various court decisions in this regards and the arguments brought forward by the proponents of the prerequisite sale and studying the available case law, we find that the perceived

[900] See also: OGH 28 January 2011, 6 Ob 231/10d, available at: http://www.ris.bka.gv.at. See on this decision also: KÖCK, 'Liability for unsuitable Advice', 461. *Comp.*: Rb Amsterdam, 13 January 2010, *JOR* 2012/79, (X./Theo Gilissen Bankiers NV); and: KCHB, 30 July 2002, *JOR* 2002/165, r.o. 5.6; K. FRIELINK in his annotation of KCD 27 August 2002, 2002-152, *JOR* 2003/90, nr. 7. *Contra*: France: CA Angers, 31 May 2011, jurisdata 2011-015101, (Le Crédit Lyonnais/Martin).

[901] LOMBARDINI, 'Le dommage du client', III.2; C. LOMBARDINI, 'Responsabilité de la banque dans le domaine de la gestion de fortune: état de la jurisprudence et questions ouvertes', *SJ II*, 2008, (415) 442. Similar: (Austria) KOZIOL, 'Incorrect advice', 6, with reference to the Austrian Supreme Court that took a similar point of view on the matter.

[902] LOMBARDINI, 'Responsabilité de la banque', 441; LOMBARDINI, *Droit bancaire suisse*, 818 ff. para. 62 ff.; and: LOMBARDINI, 'Le dommage du client', III.2. See in the same sense: KOZIOL, 'Incorrect advice', 7.

[903] Idem.

[904] Idem.

[905] Idem. *Contra*: (Switzerland) ROSAT, *Der Anlageschaden*, 65; (Austria) T. SCHOBEL and R. PARZMAYR, 'Anlegerschaden und Schadensberechnung. Ausgleich für Transaktionsschäden und Preisschäden durch Naturalrestitution und Geldersatz', *ÖBA*, 2010, nr. 3, (165) 170.

[906] With regard to court decisions and literature considering a sale required: see *supra* ftn. 898. Considering a sale not required on: (Germany) SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1745; (Switzerland) BGE, 15 January 2008, 4A_351/2007, unpublished, with ann. by CHAPPUIS, 'L'évaluation du dommage', 141-145; CHAPPUIS, 'L'évaluation du dommage', 141-145; B. CHAPPUIS, 'La détermination du dommage dans la responsabilité du gérant de fortune', L. THÉVENOZ and C. BOVET, *Journée 2008 de droit bancaire et financier*, Zürich, Schulthess, 2009, 91 ff.; ROSAT, *Der Anlageschaden*, 63; B. CHAPPUIS, 'Quelques dommages dits irréparables réflexions sur la théorie de la différence et la notion de patrimoine', *JCP II*, 2010, (165) 174. (France) CA Angers, 31 May 2011, jurisdata 2011-015101, (Le Crédit Lyonnais/Martin). (The Netherlands) Hof Amsterdam 27 April 2010, *JOR* 2010/161(van den Bogaert/ABN Amro Bank NV); Rb Amsterdam 21 December 2011, *JOR* 2012/81, (X/Wealth Management Partners NV); Rb Amsterdam, 7 March 2012, *JOR* 2012/216. See also: M.B.C. KLOPPENBURG and E.J. VAN PRAAG, 'Een vergissing van de bank in uw voordeel', *MvV* 2011, nr. 4, 93 and references cited. *Comp.* in the context of issuer liability: DE JONG, *Schade door misleiding*, 179; SPITZ, *La réparation*, 236, para 380 ff.

necessity to sell the relevant securities in order to establish damage with sufficient certainty fails to convince when examined more closely.

2. Imperfect solution to investor strategic behavior

247. One of the arguments advanced to motivate the requirement of the sale of the investment states that a sale effectively precludes that investors are enriched by claiming damages for losses resulting from defective services, while at the same time keeping the investment to take chances to recover in due time if and when market circumstances change for the better. Fluctuations in securities prices indeed cause the courts to struggle with the assessment of damages. But whereas the forestalling of strategic behavior is a justified concern, the proposed solution is no conclusive answer to the problem. Obviously, the mere requirement to sell the relevant securities cannot prevent this kind of behavior since an investor can easily and immediately acquire the very same instruments only moments after selling them (with the only expense of transaction costs).[907] Whereas the sale formally fixes his loss, he still remains in possession of the securities. The requirement of a sale is a mere formality in this scenario. Second, invariably fixing the reference date on the date of the sale does not really preclude the possibilities for opportunistic or strategic behavior. For example, knowing that losses will be compensated as they stand on the moment of liquidation, an investor may be tempted to hold on to a portfolio or certain securities after realizing that the financial service provider has breached the contract or regulatory requirements.[908] In case the portfolio improves and generates profit, the investor nets the profits whereas in case the investment (continues to) lose(s) value, the additional loss can be shifted to the defendant in a later court procedure.[909] Hence, the prerequisite sale of disputed investments is a formal and objective requirement that offers a clear point in time at which the reference date could be fixed, yet it does not effectively preclude opportunistic behavior.

3. Incomplete solution in the light of the wide range of possible claims

248. Proponents of the sale obligation also argue that the latter obligation solves the difficulties associated with setting an appropriate reference date to assess the recoverable loss. However, this suggestion only solves the matter in those cases where unsuitable or inadvertent investments have been made and does not apply to various other situations that may arise in the context of defective investment services. For instance, in those cases where a financial service provider failed to execute orders to purchase securities, a reference date tied to the sale or liquidation is obviously irrelevant since it does not concern a wrongful behavior related to the purchase of certain securities. The case brought before the lower court ("*Landesgericht*") in Nürnberg is illustrative in this regard.[910] The decision concerned a claim filed following a failure to execute an order for the purchase of 2000 securities on January 13th 2000 with a limit set at €10,70 a piece, to be executed on the Frankfurt Stock exchange. The price of the securities fluctuated at that point in time, trading under and above the

[907] See also: (<u>Austria</u>) SCHOBEL and PARZMAYR, 'Anlegerschaden und Schadensberechnung', 170; (Switzerland) ROSAT, *Der Anlageschaden*, 65; (Germany) SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1745.

[908] Similar with regard to issuer liability: M. CASPER, 'The Significance of the Law of Tort with the Example of the Civil Liability for Erroneous ad hoc Disclosure', R. SCHULZE, *Compensation of Private Losses*, Munich, Sellier European Law Publishers, 2011,102; SPITZ, *La réparation*, 236-237, para. 380; in the US literature, a similar remark was made in X., 'Measurement of Damages in Private Actions Under Rule 10b-5', 164 *Wash. U. L.Q.*, 1968, iss.1, 170.

[909] Similar: (<u>Germany</u>) SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1745; (<u>Switzerland</u>) ROSAT, *Der Anlageschaden*, 65.

[910] LG Nürnberg-Fürth, 14 November 2002, *WM* 2003, heft 18, 877. Similar: OLG Schleswig, 18 July 2002, *EWIR*, 2003, heft 2, 55; and BGH, 24 July 2001, XI ZR 164/00, *WM* 2001, heft 36, 1716.

limit set, and reaching a peak at March 10th 2000 at €14,80. Asserting that absent the wrong he would have purchased the securities at €10,70 and subsequently sold again when the peak of €14.80 was reached, the investor-claimant demanded redress amounting to €4.10 per share he would have traded.[911] In this kind of cases, an alternative to the liquidation of the investment is needed to determine an appropriate reference date.[912] Or put differently, the obligation to sell disputed investments does not offer a generally applicable approach to determine an appropriate reference date in the light of the wide spectrum of claims and variety of situations that may arise.

4. Final assessment: aligning risks with responsibility for investments

249. A final remark and objection against the obligation to sell disputed investments prior to be eligible to obtain compensation concerns the fact that this requirement disables investors who prefer to retain the investment to either monitor its evolution himself or to transfer the portfolio to another investment firm who can advice or manage on his behalf. These investors are excluded from compensation if a sale is prerequisite to file a claim, even though their decision to preserve and transfer the portfolio might be the result of changed circumstances and hope to recover by having another professional investment firm managing it or providing advice. However, since the decision to preserve the investment would result in an exclusion from compensatory damages, investors are incited to sell even though nothing prevents them from purchasing the very same securities at the same time and take the chance on improvement anyway.[913] To the extent the investors want to take the chance and bear the risk for that decision, it is also unclear why they should not be able to so. As long as the risk is allocated with the party speculating on the chances on improvements, there is no problem of strategic behavior.[914] In setting the reference date in such a manner that the investor bears responsibility for his decision to take chances and speculate on a recovery, the problem is equally solved and less cumbersome than requiring a sale, which can be easily circumvented for that matter.

250. Based on the preceding paragraphs, it can be concluded that the perquisite sale fails to offer a conclusive solution to the problem of the reference date. It was argued that the obligation to sell does not effectively forestall opportunistic behavior, while it fails to provide a generally applicable solution. Furthermore, the requirement of a prior sale also appears excessive and abundant when investors consciously and expressly choose not to sell the disputed investments and take responsibility for its further evolution. Considering these concerns to forestall opportunistic behavior and the need for a clear and generally applicable – and less excessive – solution, an alternative approach is developed and discussed in detail in the next section.

C. Reference date: adequate investor compensation and (re)allocation of investment risk

251. In the next sections, the determination of an appropriate reference date is discussed in the various factual settings that may arise. The first subsection discusses the determination of the reference

[911] In this particular case the *landesgericht* finally rejected the claim considering that the price of the securities was again under the limit from February 25 to 28 and could have been purchased without extra costs at that point in time. Additionally, the claimant could also have purchased the securities on January 14th when he was informed of the failure, especially since the defendant proposed to pay for the price difference and costs up to 500 Deutsche Mark. LG Nürnberg-Fürth, 14 November 2002, *WM* 2003, heft 18, 877.

[912] See futher below.

[913] (Switzerland) ROSAT, *Der Anlageschaden*, 65; (Germany) SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1745. *Contra:* (Germany) SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 42.

[914] (Austria) SCHOBEL and PARZMAYR, 'Anlegerschaden und Schadensberechnung', 170-171.

date in the context of defective order execution, whereas the second subsection elaborates on the determination of the reference date in the context of investment advice and asset management.

1. Order execution: reference date

252. Reporting obligation. Duty to protest – Order execution concerns the timely, correct and complete execution of an order passed by an investor in accordance with the best execution principles. MiFID and the national legislation implementing MiFID require an investment firm to report the client on the services provided on the client's behalf. In the context of order execution, clients are entitled to receive reports promptly, providing them with essential information on the executed order.[915] In those cases where orders have been wrongfully executed, or have not been executed at all, investors are generally required to protest within short notice after having received the reports on the orders executed on their behalf by investment firms.[916] In case no protest is formulated upon finding that the contract has not been adequately executed, courts generally assume that the investor has (at least tacitly) accepted the service provided and reported on in the notice.[917] The duty to protest particularly aims to enable the parties to correct mistakes immediately, if possible, and prevent or limit the harm suffered as a result of the breach as much as possible. Once the problem is noticed – or should have been noticed – investors are required to respond. Confronted with the question when to fix the reference date, courts have sometimes drawn from the fact that investors are expected to react upon realizing that a breach has occurred. More particularly, according to established case law in the Netherlands, the reference date to assess recoverable loss in the context of wrongful order execution is fixed the first trading day following the discovery of the fault.[918] The fixation of the reference date at this point in time is particularly motivated by the fact that as of this point in time, the investor is able to assess the situation as it stands and decide for himself whether it is still worthwhile to demand execution of the order again or not. Losses incurred during the period in between (i.e. between the first order and the decision to order again or not) should be compensated by the broker who committed the breach. The rule applies regardless of whether it concerns purchase or sale orders, although nuances are to be taken into account when it concerns a sale order. Some examples may illustrate the effect and benefits of such a rule in terms of adequate investor compensation and risk allocation.

253. Illustration 1. Failure to (timely) sell upon the client's request/wrongful purchase. – Situations in which a client passed an order to sell financial instruments that is not (timely) executed due to a mistake of the broker (or other situations in which the client ends up possessing instruments he did not want to possess at that point in time) offer the most straightforward example of how the reference date functions. Consider for instance a complaint that was brought before the DSI Complaints Board by an investor who subscribed to newly issued shares, allegedly with the intention

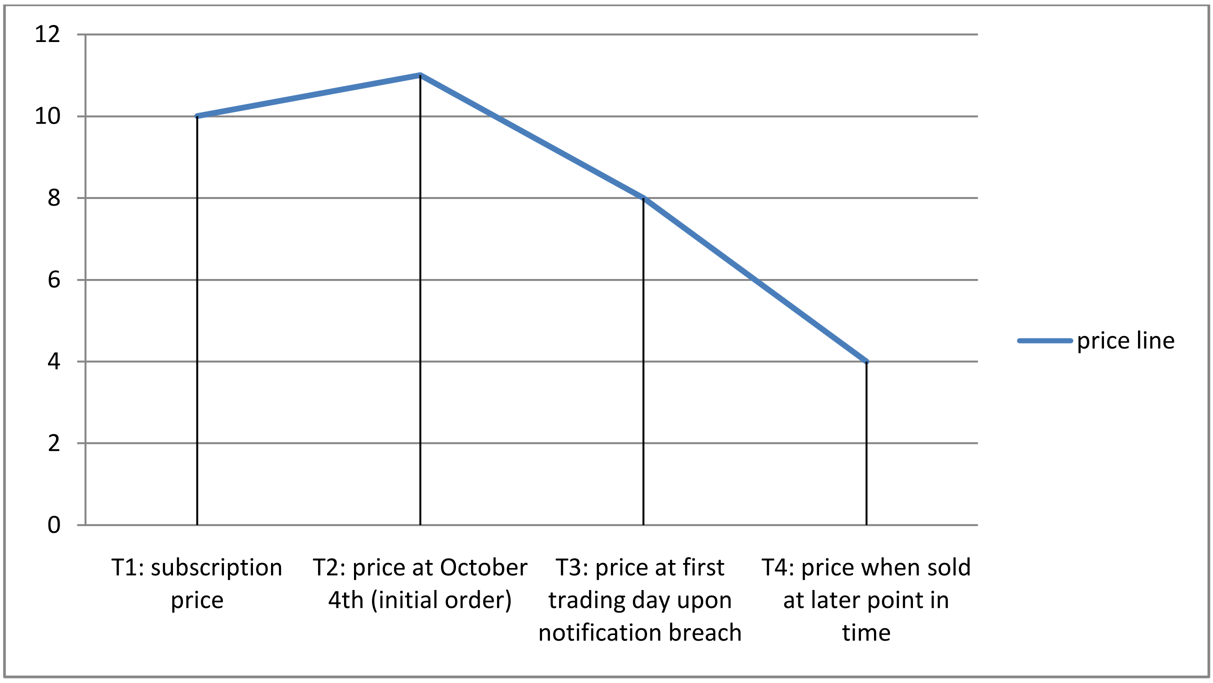
[915] Art. 40 (1) MiFID Implementing Directive. With regard to the reporting requirement applicable in case of portfolio management: art. 41 MiFID Implementing Directive.

[916] The duty to formulate a protest upon realizing that a breach has occurred has been developed by courts in various jurisdictions, yet in others this obligation has even been anchored in statutory texts. See for instance art. 6:89 DCC according to which contract parties are generally required to formulate a protest when an obligation is not adequately executed by the counterparty to the contract.

[917] Belgium: Gent, 18 February 2004, *RABG* 2005, 297 with ann. by D. BLOMMAERT; Brussel, 23 January 2004, *TBH* 2006, 112, with ann.; Rb. Antwerpen, 29 April 1992, *TBH* 1995, 1062, with ann. by J. BUYLE and X. THUNIS; Antwerpen, 11 April 1994, *TBH* 1995, 1063, with ann. by J. BUYLE and X. THUNIS; Kh. Brussel, 27 April 1992, *TBH* 1993, 1059, with ann. by J. BUYLE and X. THUNIS; Germany: S. KÜMPEL (ed.), *Bank- und Kapitalmarktrecht*, Köln, O. Schmidt, 2011, 2298, para. 17.147; The Netherlands: VAN BAALEN, *Zorgplichten*, 345.

[918] VAN LUYN and DU PERRON, *'Zorgplicht'*, 271.

to immediately sell them (October 4th). As the bank charged with the execution of the sale orders was unable to verify whether and how many of the ordered instruments were actually acquired at that point in time, however, the investor-client was unable to sell the instruments again and had to wait until the bank could give further information.[919] The situation became clear two days later (October 6th), but as the share price had declined in the meantime, the investor-claimant postponed the sale to await potential price increases in the future. The price continued to fall, however, causing the investor-claimant to sell at a loss at a later point in time. Claiming that the loss would not have been incurred, had the bank not failed to immediately sell the instruments in the first place, the investor filed suit against the bank and demanded compensation for the loss incurred, i.e. the difference between the price shortly after his subscription and the price he eventually sold at.



254. This example clearly illustrates the problem that underlies many of the claims filed in this kind of cases. Whereas it is clear that the loss would not have emerged had the bank been able to immediately sell the securities, the investor is the one who decided to hold on to the securities hoping that the price would increase, yet taking a risk as it may continue to fall too. Taking the decision to await better times clearly involves a typical investment risk, and since it was the investor who decided to take that risk, the latter is also the one who should bear the consequences of that decision. Otherwise, this would offer an opportunity for aggrieved investors to take risks at the expense of the wrongdoer, while reaping the benefits in case the risk would prove worthwhile. Reasoning along the same lines, the Complaints Board held in this case that the recoverable loss should be assessed at the moment when the investor was informed of the problem and could have reacted, in this case 6th October. The loss incurred as a result of the impossibility to sell the securities should hence be recoverable, whereas further losses incurred after that point in time should not be compensated. The

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[919] The Complaints Board ('*Geschillencommissie*' or '*GC*') issues decisions on disputes concerning financial services (including investment services, credit and loans, mortgages and insurance), which can then be appealed before the Appellate Commission ('*Beroepscommissie*' or '*GCHB*'). The decision referred to in this context concerns a decision issued by the predecessor of the current Complaints Board, the DSI Complaints Board ('*DSI Klachtencommissie*' of '*KCD*'): KCD, 27 February 2002, 2002-44, available at www.dsi.nl.

decision to preserve the shares after 6th October was made on the investor's own responsibility according to the Board and could not be shifted to the bank.[920]

255. A second example that may further clarify the relevance and effect of the rule that the loss should be fixed at the first trading day following the realization of the breach, concerns a case that was brought before the Amsterdam court of first instance. In this case, a sophisticated investor claimed damages from his broker-bank with whom the investor had signed an order execution contract and a credit facility relating to his trading activities.[921] The investor was involved in option trading, puts and calls, according to a strategy which required him to trade intensively and quickly in response to market evolutions to be successful. Planning to pass an order to cancel 60 outstanding AEX put contracts on the morning of 29th September 2008, however, the investor-client noticed that the execution service was not functioning. He kept trying to pass orders nonetheless. When called by the bank in the afternoon and asked to pass his orders via the phone if needed, the investor decided not to pass the cancellation order for 60 outstanding AEX put contracts that failed to go through the electronic system earlier that day. Instead the investor quickly came up with another strategy to rebalance the portfolio and passed a new order to trade another 60 AEX put options shortly after the phone call.[922] The investor wanted to continue trading the next morning, but failed to do so since his margin had been exceeded, causing his orders to be barred by the bank. To settle his debts, the investor was forced to close his positions, which caused him to suffer a loss of €227.100 for the 60 AEX put options he initially intended to cancel and another €161.000 on the position he took in the late afternoon the day before, originally aimed at restoring the balance. The investor-claimant blamed these losses on the broker-bank, asserting that the loss was entirely due to the order system breakdown.

256. Holding the bank liable for the deficient order execution, the court considered the scope of the recoverable loss. Referring to the claimant-investor's refusal to pass the orders via the telephone, the bank raised the defense that the investor brought most of the loss on himself as his actions had caused the loss to accumulate. Considering the course of the events, the court held that the reasonable course of action for a normally prudent investor in this kind of situation is to limit the exposure as much as possible. The court therefore concluded that because of the investor's decision to increase his exposure instead of closing the positions and take the loss, which would have been recovered from the bank anyway, the investor engaged in speculation and cannot simply shift the resulting losses to the bank. Hence, the loss is to be assessed by comparing the hypothetical situation in which no breakdown would have taken place and the actual situation as it stood on when the investor was offered the possibility to pass his orders through the phone. The losses incurred at that point in time are recoverable, whereas the additional loss suffered beyond this point in time (being the extra contracts and the evolution in the prices) taking place were to be borne by the investor-claimant.

257. **Assessment. First trading date following notification of breach-rule –** Fixing the reference date at that point in time when investors are able to respond to the breach (i.e. the first trading day after the breach is noted – or should have been noted) adequately allocates risks to those responsible for those risks, while still offering full compensation for the loss incurred as a result of the breach. More particularly, by setting the reference date on the moment when the investor-claimant could have

[920] For a similar decision: Rb Amsterdam, 13 April 2011, LJN BQ7598, (X./ABN Amro Bank NV), *JOR* 2011/224.

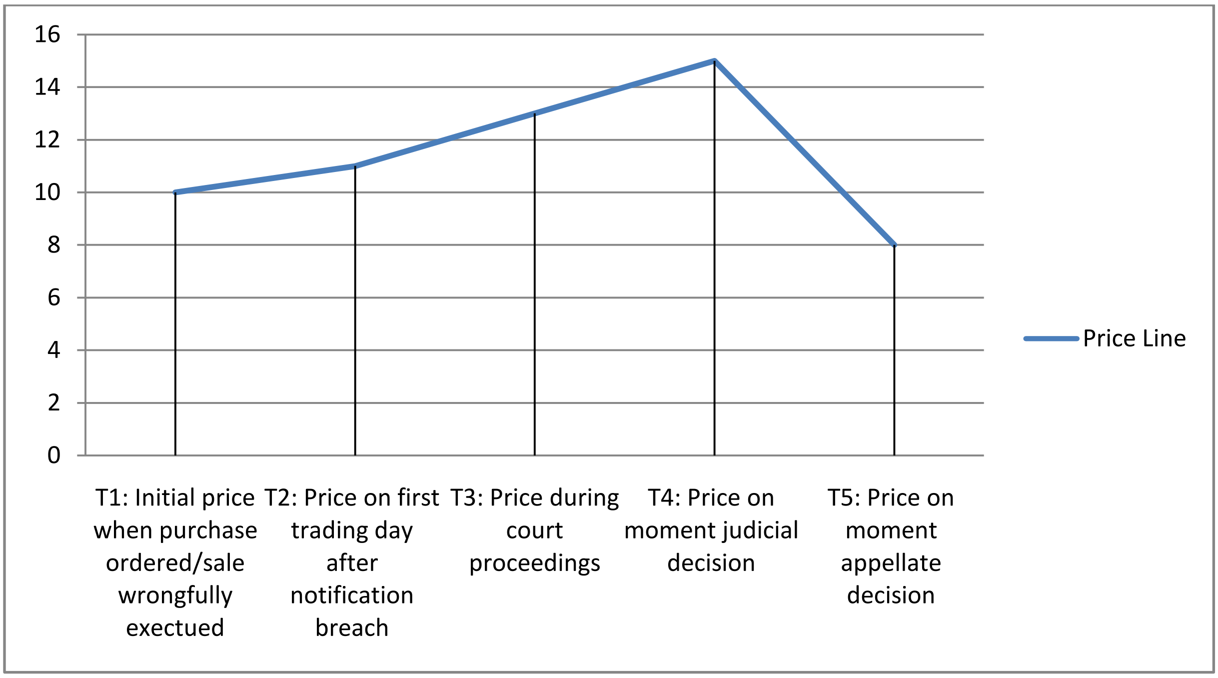
[921] Rb Amsterdam, 13 April 2011, LJN BQ7598, (X./ABN Amro Bank NV), *JOR* 2011/224.

[922] These 60 AEX option contracts were intended to counter the other outstanding 60 AEX options which had not been cancelled due to the failure of the order execution system. The investor-claimant wanted to repair the balance in the portfolio with these additional options.

been reasonably expected to take measures to limit the loss, the court allocates the risk for future price evolutions to the investor. The latter is thus forced to take responsibility for the risks he chooses to take and cannot shift this loss to the defendant, who indisputably made a mistake and will be held liable as a result, though only to the extent the investor reacted as could be reasonably expected given the circumstances of the case and his sophistication. Overall, the approach offers a solution to the problem of the appropriate reference date without allowing for free rides and can be supported from a policy perspective. Fixation of the reference date in the context of deficient order execution on the first trading day following the discovery of the fault is supported by an extensive line of case law in the Netherlands and has been applied in various other Member States too.[923]

258. Illustration 2. Failure to (timely) purchase upon the client's request/wrongful sale. From the perspective of an intended purchase of securities that fails due to a mistake by the bank, the situation is more complicated. An illustration may clarify the problem. Assume an investor who orders the purchase of an thousand financial instruments trading at €10/piece at the moment of the order. The broker fails to execute the order due to negligence on his side and notifies the client. Noting that the share price has increased to €11/piece, the investor decides not to purchase the shares anymore and files claim for compensation directed against the broker. As the price continued to climb during the court proceedings in first instance however, the claimant demands compensation based on the difference between the price as it stood at the moment when his initial order passed (T1: €10/share) and the moment of the judicial decision (T4: €15/share).

923 The Netherlands: Hof 's-Hertogenbosch 23 March 2004, LJN AO7085, (X./ING Bank NV), available at www.rechtspraak.nl, in particular r.o. 4.9; Rb Maastricht 6 June 2002, LJN AE4277, (X./ING Bank NV), available at www.rechtspraak.nl, in particular r.o. 3.6; Rb Alkmaar 11 March 2009, *JOR* 2009/136, (X./ING Bank NV); Rb Amsterdam 13 April 2011, LJN BQ7598, (X./ABN Amro Bank NV), *JOR* 2011/224; KCD, 27 February 2002, 2002-44, available at www.dsi.nl; KCD, 4 May 2001, 2001-119, available at www.dsi.nl (client-investor gave an order to sell without specifying whether it concerned a market or a limit order. Assuming the latter, the investment firm set a limit of €47 per share without verifying the details with the client-investor. Since the stock noted below €47 per share at that point in time the order was not executed. The client was informed of the failure to sell only after three days, though decided not to renew the order (shares listed at €43 at that time) but instead kept the securities at matter. The Complaints Board decides to award damages based on the difference in value as measured on the day of the order and the day the client was informed about the failure to execute the order. The investor bears responsibility for any later fluctuations pursuant to his decision not to sell.); KCD, 1 February 2001, 2001-39, available at www.dsi.nl; KCD, 7 February 2001, 2001-48, available at www.dsi.nl. See also: M. VAN LUYN and E. DU PERRON, *Effecten van de zorgplicht*, Deventer, Kluwer, 2004, 283. See also France: CA Aix-en-Provence, 8th Ch., 17 November 1994, Jurisdata 1994-048753; CA Paris, 15th Ch., 17 February 2005, Jurisdata 2005-282457, (Pernikoff/Le Crédit Industriel et Commercial de Paris); Cass., comm., 10 January 2012, n° 10-26837, with ann. by P.-Y. BÉRARD and J.-L. GUILLOT, 'La responsabilité du banquier dépositaire de titres quant à la réparation de la perte d'une chance', *Revue Banque* 2012, n° 750. Consult also: BONFILS, *Le droit des obligations*, 308, para. 626-628 and references cited: CA Limoges, 12 October 1992, Jurisdata 1992-047038, (Chabaud/S.A.BNP); CA Paris, 7 January 1992, Jurisdata 1992-020494. Similar to some extent: Germany: LG Nürnberg-Fürth, 14 November 2002, *WM* 2003, heft 18, 877 (rejected and reformed however by OLG Nürnberg, 24 November 2003, 8 U 36/03, available at: http://www.rws-verlag.de); OLG Nürnberg, 6 December 2000, 12 U 2593/00, *BB* 2001, heft 8, 380; GEIBEL, *Der Kapitalanlegerschaden*, 275 and references cited in ftn. 44; OLG Schleswig, 4 May 2000, 5 U 227/98, *ZIP* 2000, heft 39, 1721; and with regard to the latter decision, see also: BALZER; *EWIR*, 2000, heft 16, 759. *But:* BGH, 24 July 2001, XI ZR 164/00, *ZIP* 2001, heft 37, 1624, with (critical) annotation by BALZER; *EWIR*, 2001, heft 24, 1131, with ann. by HAMMEN; *WM* 2001, heft 36, 1716. Belgium: Kh. Brussel, 10 October 1995, *TBH* 1996, 1101. *Contra:* Brussel, 30 June 2003, *Bank Fin.R.*, 2004, afl. 3, 175, with ann. by V. DE VUYST. With regard to the UK, see: HUBBARD, 'Damages for breach of contract: the correct time for assessing loss', 16 and references cited. While some have considered this rule as a matter of setting the appropriate reference date, others have looked at the issue through the perspective of the duty to mitigate the loss. VAN LUYN and DU PERRON, *'Zorgplicht'*, 275.



259. The question arises whether the investor is entitled to this kind of compensation, taken into account that the broker would be held responsible for future price evolutions. But even if this would be the case, assume the following scenario in which the broker, discontent with the judicial decision, appeals the decision. As the shares started to drop shortly after the appellate proceedings begun, the broker argues that even if he is liable for the loss incurred, the loss should be adjusted in the light of the (negative) price evolution. The investor on the other hand counters the latter assertion asserting that he would have sold the shares immediately when the price started to fall (around €14/share for instance). The difficulties in assessing these allegations and claims are obvious. In line with our rule of thumb, being that the risks related to an investment decision should be attached to the party bearing the responsibility for the decisions, it could be argued that in this kind of cases as well, the reference date should be fixed at the point in time when the investor could have responded to the situation. More particularly, the investor is entitled to the difference between the price at T1 and T2 (€1000) because in absence of the wrong, he would have been the owner of shares worth €11.000 after investing €10.000. In case the investor does not want to take chances and does not invest in the securities at this point, there is no further loss to claim regardless of further price evolutions. In case the investor does invest and future fluctuations occur, either positive or negative, the result is for the investor to bear. Yet upon learning that the initial order did not go through at T1, the investor may also decide to invest the initial €10.000 at T2. As the price has increased to €11/share however, the investor will only acquire 909 shares instead of 1000. The question then arises how to compensate for the 91 outstanding shares. In this kind of cases, investors should be able to recover for the loss incurred as a result of price fluctuations between the wrongful sale (T1) and the moment on which the investor was able to decide whether he wanted the shares or not (T2). Additionally, the investor should also be entitled to compensation for losses incurred due to the 91 outstanding shares. To the extent the investor is still in possession of the instruments at the moment the judgment is delivered, the court can take the value of that date as a reference. In case the shares have been (partly) sold at a particular point in time, courts can assume that (a similar proportion of) the outstanding shares would have been sold too at that point in time.

2. Investment advice and asset management

260. Investments and transactions executed in the context of financial advice and asset management differ from order execution. First of all, in case of financial advice and even more so in case of investment management, the financial service provider is responsible for the investment policy set out for the duration of the contract. Second, the obligation to advise on or manage an investment portfolio often involves a prolonged contractual relation, while results become often visible over time following intermittent reporting by the financial service provider. As long as the contractual relation prolongs, it seems clear that financial advisors and asset managers remain responsible for advice, recommendations and information provided to the client, as well as for the investment policy and strategy they decide to recommend or follow. In case the asset manager breaches the contractual terms on the strategy to follow or the composition of the portfolio, or in case the financial advisor advises an unsuitable strategy, losses may be incurred as of the moment of the breach until the situation is rectified and the recommended investments or the investments made on behalf of the investor are in line with his profile and objectives. Alternatively, it may be that the investor loses his confidence in the financial service provider and terminates the contract. Upon termination of the contract, the financial service provider is no longer authorized to administer investments on behalf of the client or advise the client-investor, and should thus be considered not responsible anymore for decisions taken after the termination of the contract. [924] The correction of the portfolio after a breach occurred or the termination of the contract therefore often serve as a focal point to define the period of time relevant to measure the recoverable loss.[925] However, in case an investor sells the portfolio or disputed investment upon termination of the contract, or shortly after, courts have been found to set the reference date at the moment of liquidation.[926] How long it may take an investor to sell upon the termination of the contract and have the date of the sale set as the reference date depends on the concrete circumstances of the case and cannot be comprised in a general rule.[927] The complexity of the portfolio and the degree of sophistication of the investor-claimant are two examples of elements that may be taken into account to determine this period of time.

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[924] The Netherlands: Hof Amsterdam 27 April 2010, (van den Bogaert/ABN Amro Bank NV), *JOR* 2010/161; KCD 2002-151, issued on 27 Augustus 2002, *JOR* 2003/89; KCD 2002-152, issued on 27 Augustus 2002, *JOR* 2003/90 with ann. by K. FRIELINK; also available at: http://www.dsi.nl. See for similar applications also the advice issued by predecessor of the current Complaints Board (‘*Klachtencommissie DSI’* or ‘*KCD’*) after a complaint by a disappointed investor. In this case the investor had terminated the contract after finding the asset manager had acted contrary to what had been agreed shortly before. Instead of reducing the client’s portfolio as agreed, the asset manager bought more securities causing the investor to suffer additional losses. Upon termination of the contract, the client however remained in possession of the disputed securities instead of selling them and further value declines were registered. Since the asset manager was no longer in charge of the portfolio at that time, the Commission considers the latter not responsible for the losses suffered following the termination of the contract. KCD 2001-143, issued on 3 July 2001 and available at: http://www.dsi.nl. Switzerland: BGE, 15 January 2008, 4A_351/2007, unpublished, with ann. by CHAPPUIS, 'L'évaluation du dommage', 141-145; THÉVENOZ and BRETTON-CHEVALLIER, 'Switzerland', para. 10.78. France: CA Paris, (15th Ch.), 2 October 2001, Jurisdata 2001-160531 (Wargny/X.).

[925] Switzerland: BGE, 15 January 2008, 4A_351/2007, unpublished, with ann. by CHAPPUIS, 'L'évaluation du dommage', 141-145; ROSAT, *Der Anlageschaden*, 78 ff. The Netherlands: Rb Amsterdam, 26 September 2007, LJN BB7169, (X./Degroof & Cie Vermogensbeheer B.V.); Hof Amsterdam, 27 April 2010, (van den Bogaert/ABN Amro Bank NV), *JOR* 2010/161; KCD 2002-151, issued on 27 Augustus 2002, *JOR* 2003/89; KCD 2002-152, issued on 27 Augustus 2002, *JOR* 2003/90 with ann. by K. FRIELINK; KCD 2001-143, issued on 3 July 2001 and available at: http://www.dsi.nl; TOXOPEUS-DE VRIES, 'Het begroten van beleggingsschade', 247-248. Belgium: Rb Brussel, 3 October 2011, *THB* 2013, afl. 7, 624.

[926] Switzerland: ROSAT, *Der Anlageschaden*, 80.

[927] *Ibid.*, 81; Germany: MÜLLER notes that in the context of asset management an investor may be allowed four weeks to six months after terminating the contract to decide whether or not to liquidate, depending on the complexity and the circumstances of the case. Within this period, the investor can consult a professional on the matter. SCHÄFER and MÜLLER, *Fehlerhafte Wertpapierdienstleistungen*, 150, para. 371.

Summarized, the fixation of the reference date in the context of financial advice and asset management should be based on the moment when the fault is rectified in case the parties decide to continue their contractual relation. Alternatively, if the contract is terminated, the termination of the contract or liquidation of the investments, provided that liquidation takes place within a reasonable time frame given the circumstances of the case and the sophistication of the investor. Yet, in certain circumstances deviations from these principles may occur as a result of the investor's breach to mitigate the loss. Dutch courts for instance have occasionally decided to set the reference date at the moment when the investor discovered – or should have discovered – that a breach had occurred, yet did nothing to rectify the situation.[928] Again, the underlying motivation to do so lay with the courts' concern not to invite or allow investors to speculate at the expense of the defendant, knowing that the losses incurred can be recovered from the defendant anyway.[929] The relevance and implications of the obligation to mitigate the loss in the context of asset management and financial advice and the potential consequences are discussed in more detail when the limits to compensatory damages are examined.[930]

261. Long term strategy-argument – Confronted with an investor suit claiming for damages, defendants sometimes argue that the investment were made or advised based on the investor's time horizon, and that the effect of the advice or portfolio management should be assessed in the light of that time horizon.[931] Although it is not questioned that long term investments may be expected to prove profitable over time, this does not change the fact that a breach has occurred. If an investor finds that his portfolio is undiversified as a result of a breach by an investment firm, or realizes that investments or strategies have been recommended or advised that are unsuitable in the light of his objectives or profile, there is generally no obligation for the investor to wait and see whether recovery occurs.[932] Moreover, upon discovery of the breach, an investor is generally required to respond and – if possible – mitigate the accumulation of losses, for instance by complaining and demanding corrective measures and adjustments, or even selling off the unsuitable investments and/or terminating the contract.[933]

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[928] Hof Amsterdam 15 May 2008, *JOR* 2008/305, (Heijmans/ING Bank NV); Rb Amsterdam 18 July 2012, *JOR* 2012/359, with ann. by J.W.P.M. VAN DER VELDEN, in particular r.o. 4.29. The court sets the reference date – in correspondence to what the claimants suggested – at the day the claimants expressed their concerns and objections regarding the investment policy adopted by the asset manager. See also: TOXOPEUS-DE VRIES, 'Het begroten van beleggingsschade', 248. See for instance also the Belgian decision issued by the Brussels appellate court in this regard, fixing the reference date at the moment the investor-claimants were duly warned regarding the risk their portfolio held. The bank-defendant was held liable for the loss incurred as a result of the failure to warn earlier, though a limit was set at the moment the belated warning was given. Brussel 27 April 2012, *JLMB* 2012, no. 25, 1203. See also: Bergen, 7 October 2004, *Bank. Fin.* R. 2006/II, 94, with ann. S. DELAEY. See also: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 311; Rb. Verviers, 29 May 2006, *TBH* 2008, afl. 1, 96.

[929] VAN BAALEN, *Zorgplichten*, 419.

[930] See *infra*: para. 295.

[931] For an example, see Amsterdam, 12 January 2011, *JOR* 2012/79; Kh. Brussel, 2 March 2011, *TBH* 2012, afl. 4, 378.

[932] VAN BAALEN, *Zorgplichten*, 424. Also: (The Netherlands) Rb Amsterdam, 21 December 2011, *JOR* 2012/81, (X/Wealth Management Partners NV). (Belgium) Rb Brussel, 24 February 2012, *Bank. Fin. R.* 2012/II, 128. (Austria) KOZIOL, 'Incorrect advice', 6-7. (Germany) AG Leipzig, 10 November 2008, 115 C 3759:08, *BB* 2009, heft 6, 240 ("Der Klägerin steht es aufgrund der Falschberatung frei, die Anlage zu verkaufen"). *Contra:* Rb Amsterdam, 12 January 2011, *JOR* 2012/79.

[933] Idem. In various jurisdictions, the modalities and conditions applicable to the termination of investment services contracts is specifically arranged in mandatory legislation, especially when it concerns asset management. Germany: In case the asset manager has discretionary powers to carry out the contract, the client is entitled an unlimited right to terminate the contract. See for instance: CASPER and ALTGEN, 'Germany', 111, para. 4.60. Additionally, the contract itself will generally include provisions on the termination of the contract SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §5, para. 45. Since asset management concerns a contract to be executed on a continuous, prolonged basis, the contract can be terminated without costs when there is sufficient reason to do so, for instance when the asset manager breaches the contract, causing the investor-claimant to lose confidence. BALZER, 'Vermögensverwaltung', 1503, para. 67 ff. On the conditions and regulation to terminate investment management contracts in the UK, see extensively: SPANGLER (ed.), *Investment Management*, 339 ff.

III. Determination of the hypothetical alternative scenario

A. Rescission/rescissory damages

262. Validity/enforceability of the contract affected. – For the sake of completeness, it is repeated, that in some instances, investors can demand to have a contract rescinded or annulled.[934] Following rescission, annulment or unenforceability of contracts, parties may be entitled to full restitution, as if the contract had never been concluded.[935] This may imply that the initial amount of money paid to acquire investments or instruments is returned to the investors.[936] For instance, according to s.26 and s.27 FSMA, financial service contracts concluded by non-authorized persons who carry out activities that require prior authorization, are unenforceable, while the counterparty is entitled to reclaim the money or other property paid or transferred under the agreement.[937] According to Belgian law, subscriptions to public offers while no a duly approved prospectus was available, or participations in collective investments in the context of open ended-UCITS in absence of prior approved key investor information documents, are null and void.[938] According to Belgian law, the nullity sanction requires that the parties are restored in the position as if the contract was never concluded, implying that the investors recover the money paid to acquire the instruments.[939]

263. UK tort law. Fraudulent misrepresentation: rescissory damages. – The rescissory measure to assess recoverable loss is also applied in the UK tort of fraud. As confirmed by the House of Lords in *Smiths v New Court*, victims of fraudulent misrepresentations are entitled to damages that compensate for the entire loss caused by the victim's reliance on the fraudulent statement or conduct.[940] More particularly, in case of securities transactions or investments induced by fraudulent statements or behavior, victims are entitled to damages for the entire loss caused because of entering into the transaction, being the difference between what has been paid and what has been received following the transaction one was induced to enter into as a result of the fraud.[941] As fraud requires that claimants establish that the misrepresentations were made with fraudulent intent on the side of the wrongdoer, claimants often find the evidential threshold relatively high and often too high to meet. Claims for damages pursuant to defective investment services are therefore often filed under s.138D

France: the client is entitled to terminate an asset management contract regardless of whether a fixed duration had been contractually agreed on. These rules have been laid down in mandatory rules rendering contrary clauses to the contrary void. See: COURET, GOUTAY and ZABALA, 'France', 62-63, para. 3.18. The Netherlands: art. 7:422 (4) DCC. The client-investor may terminate the (asset management) contract at wish. This is a mandatory rule with regard to private individuals not acting in the course of a business or profession (BUSCH and SILVERENTAND, 'The Netherlands', 215, para. 7.74). Luxembourg: Asset management contracts can be terminated at the client's request; BOURIN, *La gestion de portefeuille*, 267; the author also notes that the termination of an asset management contract is often motivated by an investor's discontent.

[934] See *supra*, Part I, Chapter III.

[935] See *supra*, para. 120 ff., 125 and 128. See also the references cited in ftn. 477.

[936] Idem.

[937] See *supra*, para. 121.

[938] Art. 86ter, §1, 1° and 2°(with regard to prospectuses) and art. 285bis (with regard to UCITS) Law on Financial Supervision. See *supra*, para. 122.

[939] Extensively with regard to nullity and restitution in this context according to Belgian law: RAVELINGIEN, Privaatrechtelijke handhaving, 179.

[940] See *supra*, para. 116.

[941] See in this regard: Twycross v. Grant, (1877) 2 C.P.D. 469 CA, at 543. See also: McConnell v. Wright, (1903) 1 Ch. 564 CA; Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254. See also *supra,* ftn. 435.

FSMA or under the tort of negligence, yet restrictions on the recoverable loss – such as foreseeability and remoteness of the loss – may apply under these causes of action.[942]

264. Germany. Rückabwicklung/Naturalrestitution. – According to §249 I BGB and the doctrine derived from this provision, compensation should principally consists of restitution in kind (‘*Naturalrestitution*’).[943] In case contracts have been concluded as a result of precontractual information obligations, the contracts are generally rescinded. As a result, German courts generally allow investors to claim the money paid to acquire the disputed investment or securities in return for the securities (‘*Zug um Zug Rückabwicklung*’).[944] In case the securities have been sold already, the investor is compensated for the difference between initial investment value and the selling price.[945] This approach is generally applied in the context of unsuitable financial advice, for instance, and allows investors to rescind the contract and return the instruments in return for the money paid to acquire the latter. Alternatively, the investors may also decide to keep the instruments and are entitled the difference between the initial amount of money paid to and the remaining value of the investment (assessed on the day of the last oral debates).[946] Whereas wrongdoers are allowed to establish evidence that (part of) the loss would also have been suffered in case the asset manager would have complied with the terms, guidelines and strategy agreed on in the contract[947], this approach is generally not allowed when it concerns precontractual breaches and violations of information obligations.[948] As a result, it is not investigated what alternative investments or investment strategies the investor would have agreed on in case of financial advice and precontractual breaches in the context of asset management.[949]

In these situations, it is simply held that the contract or the investment would not have been concluded or made absent the wrong, implying that the parties are to be restored into their positions as if the investment would not have been made. Additionally, the comparison with alternative hypothetical investments is also considered too hypothetical to take into account, according to the German case law and scholarly literature.[950] Hence, in these cases, courts are not required to assess the alternative

[942] See *supra*, para. 154.

[943] See also *supra*, para. 0.

[944] EINSELE, *Bank- und Kapitalmarktrecht*, §8, para. 43.

[945] LG Frankfurt, 1 March 2010, *WM* 2010, heft 28, 1317; SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1745. This is also the remedy adopted by the legislator in the context of prospectus liability as laid down in the statutory regime of §21 ff. WpPG. See *infra*: para. 351.

[946] ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §4, para. 123 (Financial advice); §23, para. 58 (asset management); D.H. VELDHOFF, *Die Haftung von Kreditinstituten für die fehlerhafte Aufklärung und Beratung von Privatkunden beim Erwerb von Zertifikaten*, Baden-Baden, Nomos, 2012, 135; HELLGARDT, *Kapitalmarktdeliktsrecht*, 492. *Comp.*: SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 40 ff.; *Contra*: BALZER, 'Vermögensverwaltung', §51, 1495-1496, para. 51. See also: WAGNER, 'Schadensberechnung', 507-509; extensively and with historical overview in literature and jurisprudence: GEIBEL, *Der Kapitalanlegerschaden*, 66 ff. With regard to asset management: BENICKE, *Wertpapiervermögensverwaltung*, 834. *Comp*. also with the decision handed down by the Swiss Bundesgericht on 7 October 1997: BGE 124 III 155; P.C. GUTZWILLER, 'Schadensstiftung und Schadensberechnung bei pflichtwidriger Vermögensverwaltung und Anlageberatung', 101 *SJZ/RSJ* 2005, 362; GUTZWILLER, 'Unsorgfältiger Vermögensverwaltung', 64.

[947] BAMBERGER, 'Anlageberatung', 1468, para. 188. See in this regard also: H.D. ASSMANN and R.A. SCHÜTZE, *Handbuch des Kapitalanlagerechts*, München, Beck, 1997, 1178, §28, para. 53; BENICKE, *Wertpapiervermögensverwaltung*, 832; BALZER, 'Vermögensverwaltung', §51, 1495-1496, para. 51; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 41; CASPER and ALTGEN, 'Germany', 125, para. 4.122-123.

[948] BAMBERGER, 'Anlageberatung', 1468, para. 188; more extensively: GEIBEL, *Der Kapitalanlegerschaden*, 441 ff.

[949] On the other hand, in case it concerns violations that occurred in the execution of the asset management contract, such as a violation of the agreed strategy and investment guidelines, comparisons with alternative investments to determine the recoverable loss are allowed. *Supra*, ftn. 947.

[950] BAMBERGER, 'Anlageberatung', 1468, para. 188; GEIBEL, *Der Kapitalanlegerschaden*, 441 ff.

scenario to assess the recoverable loss and simply apply the rescissory measure. Yet, considering the implications of this system, some objections may be raised. For instance, as GEIBEL observes, even though courts consider a comparison with alternative hypothetical investments too hypothetical to determine the recoverable loss, investors are nonetheless allowed to claim foregone profits that they would have received in (the hypothetical) case they had been advised on a more suitable and appropriate investment.[951] Moreover, confronted with the question whether claimant-investors can demand damages for unrealized gains in case restitution (*Rückabwicklung*') is granted, the BGH held that compensation for unrealized gain is not precluded by the principle of '*Naturalrestitution'* as stated in §249 I BGB.[952] GEIBEL notes that this leads to a rather inconsistent outcome since the defendant is precluded from establishing proof that (part of) the loss would also have been suffered had an alternative investment been chosen, while the claimant may attempt to establish a claim for lost profits based on potential alternative investments.[953] The fact that no comparison with any hypothetical alternative investment is carried out in combination with the '*Vermutung Aufklärungsrichtigen Verhaltens'*[954] also implies that investor claims following precontractual breaches and erroneous advice are rather generously treated by the German courts.

265. A second objection relates to the fact that the rescissory method essentially allows investors to recover each and every loss the disputed investment has recorded, including loss (or part of it) that would also have been suffered in case an alternative investment had been chosen, for instance because it relates to general market tendencies. Put differently, under the rescissory measure, instead of investors, *wrongdoers* bear the risk that investments lose value over time as a result of market tendencies and evolutions.[955] As pointed out in one of the previous chapters, this may be one of the reasons why courts in other legal systems have adopted a rather reluctant stance towards nullity sanctions in the context of investor losses.[956] More particularly, considering that risks inherent to investment activities are to be borne by investors and not wrongdoers, these courts seem inclined to exclude compensation for losses caused by market factors that would have equally been suffered in case a more suitable, alternative investment would have been chosen.

This point of view is for instance illustrated by the Austrian case law. The Austrian legal framework resembles the German system to a certain extent with regard to the concept of '*Rückabwicklung'* or restitution. In case erroneous information or advice has been provided, or 'know your customer'-rules have been breached, the primary means to remedy the loss suffered as a result of the unsuitable and/or undesired investments is restitution in kind, as is the case in Germany. Other than is the case in Germany however, the investor-claimant does not receive the entire initial investment amount upon returning the shares. More particularly, in one of its decisions on this matter, the Austrian Supreme Court stressed that it cannot be assumed that the investor would have chosen a totally risk-free

[951] GEIBEL, *Der Kapitalanlegerschaden*, 441-444.

[952] BGH, 13 January 2004, XI ZR 355/02, *BB* 2004, 515; *WM* 2004, 422. See also: BAMBERGER, 'Anlageberatung', 1467, para. 185.

[953] GEIBEL, *Der Kapitalanlegerschaden*, 443. It should be noted however that damages for foregone profits in this context are not easily obtained. See in this regard: BGH, 24 April 2012, XI ZR 360/11, *BKR* 2012, 291; *ZIP* 2012, heft 25-26, 1230. Instead of foregone profits, court generally award interests. See also: JORDANS, 'Information duties', 19; HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 180.

[954] See *supra*, para. 200.

[955] See also: MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 280.

[956] See *supra*, para. 127 and ftn. 484.

investment if he had been adequately informed.[957] Instead, the recoverable loss corresponds to the (negative) difference with what would have been achieved with a (hypothetical) better suited, alternative investment.[958] The investor can also demand to be provided with the alternative investment he would have chosen instead of the disputed investment(s) in return for the latter.[959] In case the securities have been sold, the claimant is entitled to monetary compensation equal to the difference between the hypothetical alternative investment and the actual, disputed investment, reduced with the proceeds of the sale.

266. Criticism in the German scholarly literature. - The fact that precontractual breaches, such as a violation of the 'know your customer'-rules, are compensated via restitutionary measures, whereas the wrongful execution of the contract is remedied by comparison with the alternative course of action, has drawn criticism in the scholarly literature. ASSMANN, BENICKE and BALZER for instance (correctly) contend that in spite of precontractual breaches in concluding an asset management contract, it is highly unlikely that the investor-claimant would not have concluded another (more suitable) contract in case of compliance with the 'know your customer'-rules and information obligations.[960] These authors therefore criticize the artificiality of the approach used to remedy the breaches. Additionally, it has also been asserted that the impact of restitution in the context of prolonged contractual relations is too far-reaching and undesirable. More specifically, it was asserted that transactions effectuated in the past should not be reversed in the context of a long term agreement for reasons of legal certainty and the complexity associated by the reversal of executed transactions.[961] Hence, ASSMANN and BENICKE argue that restitution should not be applied once the execution of the contract has been initiated.[962] Instead, (monetary) damages based on the comparison with the alternative investment are considered a better suited and less artificial remedy for the loss suffered. This is also the approach employed in various other legal systems, as discussed in the next section.

B. Hypothetical alternative scenario: determination

267. The method to determine whether or not losses are causally related to the established breach is generally referred to as the Difference theory ('*Differenzhypothese*') and entails a comparison between the hypothetical scenario in which no breach was committed on the one hand and the actual situation in which wrongful conduct is taken into account on the other.[963] The determination of the alternative

[957] OGH, 28 January 2011, 6 Ob 231/10d, available at: http://www.ris.bka.gv.at. See on this decision also: KÖCK, 'Liability for unsuitable Advice', 461.

[958] *Ibid*,. 463.

[959] Idem.

[960] ASSMANN and SCHÜTZE, *Handbuch des Kapitalanlagerechts*, München, Beck, 1997, §28, para. 53; BENICKE, *Wertpapiervermögensverwaltung*, 832; BALZER, 'Vermögensverwaltung', §51, 1495-1496, para. 51. SCHÄFER holds that when the claimant-investor would have concluded another, more suitable contract in absence of the wrong, not the negative but the positive interest is relevant to determine the recoverable loss. SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, 418, para. 41. See for a similar remark: CASPER and ALTGEN, 'Germany', 125, para. 4.122-123.

[961] ASSMANN and SCHÜTZE, *Handbuch des Kapitalanlagerechts*, München, Beck, 1997, §28, para. 53; BENICKE, *Wertpapiervermögensverwaltung*, 224-226. See also: SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1745.

[962] Idem.

[963] The concept of the hypothetical alternative is referred to as '*rechtmäßigen Alternativverhaltens*' in Germany; see for instance: PALANDT (ed.), *Bürgerliches Gesetzbuch*, Vor §249 BGB, para. 105. Similar: Belgium: '*rechtmatig alternatief'/'théorie de l'alternative légitime';* see for instance*:* BOCKEN and BOONE, *Schadevergoedingsrecht*, 73; B. DUBUISSON, V. CALLEWAERT, B. DE CONINCK and G. GATHEM, *La responsabilité civile: chronique de jurisprudence 1996-2007*, Volume 1: le fait générateur et le lien causal, Bruxelles, Larcier, 2009, 329, para. 395. With regard to the Netherlands: the term '*vermogensvergelijking'* is used, with reference to the German *Differenzhypothese*. See for instance: VAN BAALEN, *Zorgplichten*, 405. Switzerland: '*Rechtmäßigen Alternativverhaltens*' or '*le comportement de substitution licite*': CHAPPUIS,

scenario is generally difficult as it cannot be determined with entire certainty what alternative course of action or which particular alternative investment or investment strategy an investor would have decided on absent the wrong. However, once transaction causation has been proven (or has been presumed and not successfully rebutted), the question arises what the investor would have done absent the wrong. Two options remain in this stadium of the procedure. One possibility entails that the investor may not have invested and put his money on a savings account. Alternatively, the investor may also have decided to invest differently. Both scenarios are discussed in more detail in the next paragraphs.

1. Overview

268. First hypothesis: no alternative investment would have been made in absence of the wrong. – In some instances, it may be that the investor would have decided not to invest in case he had been duly warned or correctly and adequately informed on the risks inherent to investments. Or that in case a (correct) investor profile had been composed in accordance with the KYC-rules, it would have turned out that in the light of his profile, the client did not qualify for any investment. In these cases, it can be concluded that no investments would have been made and that the money should or would have been placed on a savings account. This is illustrated by the decision in *Rubenstein* for instance, in which private retail customer sought a safe investment for the proceeds of the sale of his home, conditional upon assurances that the invested funds could be withdrawn easily and that principal sum was not at any risk.[964] The only reason why the client informed for investments concerned the possibility to get a higher interest rate than standard bank deposit, yet the client clearly stated that he could not afford to put the principal sum at any risk. The bank advised to invest in an AIG (Premium Access) Bond and confirmed that the investment was as riskless as a bank deposit in answer to the client's question. Later on, as Mr. Rubenstein wished to withdraw his investment in a response to the increasing market turmoil in 2008 from which AIG was also suffering, he only recovered the initial investment partially. Assessing the client's claim for damages, the appellate court held that since the client had clearly indicated to prefer an investment as riskless as a bank deposit, it was within the bank's duty of care to protect the client against exposure to risks related to investments. The bank should have told the investor that the advised investment was not as riskless as a bank deposit or not advise any investment at all. According to the court, the client was entitled to rescissory damages, being the difference between the residual value of the financial instruments or portfolio on the one hand, and the initial investment value (rescissory damages), to which interest was added.

269. Second hypothesis: in absence of the wrong, a more suitable investment would have been made. – Different from the example in the preceding section, however, clients demanding advice or consulting with an asset manager are often seeking to invest and willing to accept the risk inherent to investment activities. In these cases, the hypothetical investment or strategy that would have been agreed on by the investor must be determined. In case of a failure to correctly and/or timely execute an order, the loss corresponds to the negative difference between the hypothetical situation in which the order was correctly and timely executed with the actual situation in which this is not the case. With

'Détermination du dommage', 103; ROSAT, *Der Anlageschaden*, 36; T. PROBST, 'La causalité aujourd'hui', B. CHAPPUIS and B. WINIGER, *Les causes du dommage*, Journée de la responsabilité civile 2006, Genève, Schulthess, 2007, 15. For a legal comparative perspective on the theory of the hypothetical legitimate alternative', see: K. GRECHENIG and A. STREMITZER, 'Der Einwand rechtmäßigen Alternativverhaltens - Rechtsvergleich, Ökonomische Analyse und Implikationen für die Proportionalhaftung', 73 *RabelsZ*, 2009, 336-371. See on the '*Differenzhypothese'* also: *supra*, para. 138.

[964] HSBC. Rubenstein v. HSBC Bank Plc (2012) EWCA Civ 1184.

regard to violations of ‘‘know your customer’-rules or information obligations, the outcome of the hypothetical, more suitable investment is decisive to assess the loss compared with the actual situation. Contractual breaches, such as the failure to comply with the agreed investment guidelines or an inadequate diversification, are compensated based on a comparison with a hypothetical investment portfolio compliant with the guidelines and required level of diversification.

270. In short, the assessment of the damages requires the reconstruction of the hypothetical alternative scenario in which the wrongful act did not occur. The reconstruction of this alternative scenario first requires the courts to determine what kind of investment would have been made or how the portfolio would have been composed in absence of the breach. Next, the performance of the reference portfolio or alternative investment must be determined. Even though the reconstruction of the hypothetical scenario in which the breach would not have occurred, may involve a (sometimes relatively high) degree of uncertainty, some techniques may be employed to facilitate the process.

2. Reconstruction of hypothetical investments: reference portfolio

271. The composition of reference portfolios. Type of instruments and allocation – In case one or a few wrongful transactions have been executed or recommended, the offensive transactions are easily identified. Losses can be measured either by compensating the costs of corrective trades, or alternatively by comparing the actual result with (the average result of) correctly executed and representative transactions within the relevant time period.[965] In a Swiss decision for instance a claimant-investor sued the asset manager for the wrongful reinvestment of his funds after the maturity date of his former investment US and Canadian treasury bills expired.[966] To assess the hypothetical outcome of a correctly executed asset management contract, the court assumed that in absence of the wrong, the funds would have been invested in highly similar Treasury bills, with an identical maturity and in the corresponding currency.

272. In case the wrongful behavior encompasses the composition of the portfolio, however, it may be necessary to reconstruct a hypothetical alternative portfolio with a correct composition, assessed in the light of the client’s objectives and profile. This is for instance the case when an unsuitable investment strategy was agreed on or inappropriate guidelines were drafted due to a breach of the ‘know your customer’-rules. Other examples include breaches of the duty to comply with agreed investment guidelines or the duty to diversify and breaches of the duty to warn with regard to certain strategies or envisaged investments. In these instances, a (hypothetical) reference portfolio can be composed to determine the outcome of the investment in absence of the wrong. For instance, if a highly offensive strategy was erroneously followed or recommended, courts generally seek to compare the negative outcome with the result that would have been obtained with a portfolio managed according to a neutral, defensive or conservative strategy, as deemed appropriate in the light of the investor profile.[967] The investor profile may be derived from the information gathered by the financial

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[965] (Germany) SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 44. (Switzerland) GUTZWILLER, 'Unsorgfältiger Vermögensverwaltung', 63. In these cases, transactions that exceed the mandate that was given to the asset manager, may also be considered non-imputable to client. See in this regard: KRUITHOF, 'Privaatrechtelijke werking', 323, para. 46. See also *supra*, para. 128.

[966] HGer ZH, 27 June 2006, ZR 106, (2007), 12; see also: HGer ZH, 18 November 2003, confirmed by the Bundesgericht: BGer 4C.18/2004, 3 December 2004, available at http://www.bger.ch. See also: ROSAT, *Der Anlageschaden*, 106.

[967] See also: (the Netherlands) VAN BAALEN, *Zorgplichten*, 409 and references cited. For examples, see for instance: Rb Amsterdam 26 September 2007, LJN BB7169, available at www.rechtspraak.nl; Rb Amsterdam 24 January 2007, *JOR* 2007/94, (Laan/Wijs & Van Oostveen BV), with ann. by F.M.A. ’T HART; Rb Dordrecht 31 January 2007, LJN AZ8212,

service provider with regard to the investment objectives, the experience and knowledge with regard to financial matters, the return sought by the investor-claimant[968] and the like. Once the profile is ascertained, a portfolio matching the profile is composed. To determine the portfolio, the different financial instruments that should have been invested in is determined, as well as their allocation. Besides the allocation in terms of type of instrument, diversification over the various sectors and/or regions in which the resources would have been invested has been a source of dispute too. To reconstruct the composition of the reference portfolio, courts can draw on the composition of funds for corresponding investor profiles or standard or reference portfolios (‘*Musterportefeuilles’* or ‘*normportefeuilles*’) used by professional financial service providers in function of the investor profile can serve as an indication or example. Alternatively, courts can also call upon an expert to provide the court with technical expertise.[969]

273. Illustrations. – A decision handed down by the Amsterdam Court of First Instance offers a clear illustration of how reference portfolios and the allocation of the funds in a hypothetical scenario, based on the investor profile of the investor-claimant.[970] The case concerned a claim directed against an asset manager who had neglected to draw up an adequate client profile and consequently failed to sufficiently diversify the investments made on behalf of the claimant-investor as 100 percent of the funds had been invested in stock, with an average of 50,36 percent invested in ICT stock. The court held that the manager had employed an extremely offensive investment strategy while a plain offensive strategy – with a sufficient level of diversification – would have suited the client better in the light of his profile and objectives. Based on the documentation provided by the parties, the court decided that an allocation of 70 percent of the funds in stocks, 25 percent in obligations and the remaining 5 percent in real estate would have been more appropriate. In another decision in which the court found that an ‘extremely offensive’ strategy had been wrongfully employed instead of a neutral strategy, a similar fictitious reference portfolio was designed to compare the result that would have been obtained with the actual result to assess the damages.[971] Construing a reference portfolio, the court asserts that 40 percent of the resources should have been allotted to shares and options, 45 percent to bonds, 10 percent to real estate and 5 percent liquidities.[972] Considering the sectoral

(X./ABN Amro bank NV), available at www.rechtspraak.nl; Rb Amsterdam 24 July 2009, LJN BJ2309, available at www.rechtspraak.nl; Hof ‘s-Hertogenbosch 14 September 2010, *JOR* 2011/116; Rb Rotterdam 18 July 2002, *JOR* 2002/167; Rb Amsterdam 18 July 2012, LJN BX8774, *JOR* 2013/359; also available at www.rechtspraak.nl; Rb Amsterdam, 12 January 2011, *JOR* 2012/79. (Germany) OLG Frankfurt, *WM* 1996, 665; BALZER, 'Vermögensverwaltung', §51, 1496, para. 51; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 44; BENICKE, *Wertpapiervermögensverwaltung*, 843. (Belgium) Brussel, 27 April 2012, *JLMB* 2012, no. 25, 1203; Brussel, 9 February 2012, *DAOR* 2012, nr. 102, 235; Rb Brussel, 3 October 2011, *THB* 2013, afl. 7, 624. UK: VAN SETTEN, *'The law of institutional investment management'*, 122.

[968] See for instance Rb ‘s-Hertogenbosch, 28 December 2011, (X./van Lanschot Bankiers NV), *JOR* 2012/50, r.o. 4.25. In this decision the court refers to the return set at 4 percent to 5 percent to determine the type of bonds the claimant should have been advised by the bank had a correct profile been drawn.

[969] (Switzerland) ROSAT notes in this regard that reference portfolios are theoretically sound concepts to assess the loss, yet in practice, the necessary information and technicalities are unknown to and inaccessible for (Swiss) courts. A similar comment is made by THÉVENOZ and BRETTON-CHEVALIER, pointing out that not much information relevant in this regard is made public and hence available to be used in litigation. See ROSAT, *Der Anlageschaden*, 103; THÉVENOZ and BRETTON-CHEVALLIER, 'Switzerland', 322, para. 10.76. (The Netherlands) Rb Amsterdam 18 July 2012, *JOR* 2012/359, with ann. by J.W.P.M. VAN DER VELDEN, r.o. 4.29. See also: TOXOPEUS-DE VRIES, 'Het begroten van beleggingsschade', 243. Belgium: Rb Brussel, 3 October 2011, *THB* 2013, afl. 7, 624.

[970] Rb Amsterdam 24 January 2007, *JOR* 2007/94, (Laan/Wijs & Van Oostveen BV), with ann. by F.M.A. ’T HART. See for other examples using reference portfolios also the decisions referred to in ftn. 967.

[971] Rb Amsterdam 26 September 2007, LJN BB7169, available at www.rechtspraak.nl.

[972] Rb Amsterdam 26 September 2007, LJN BB7169, available at www.rechtspraak.nl, r.o. 4.11.2. The facts or data underlying and supporting this particular allocation applied by the court are not mentioned in this decision, though the court indicates that in case of dispute it may call upon experts to decide on an adequate asset allocation.

distribution of the portfolio, the court applied the sectoral distribution of the AEX index over the relevant period of time. The court allows the parties to challenge this method of damage assessment and indicates that in case of dispute, it may call upon experts to decide on an adequate asset allocation.

3. Performance of the reference portfolio

274. Performance of reference portfolios. – Once the relevant reference portfolio has been composed in line with the investor profile and objectives, the performance of the reference portfolio is assessed and compared with the actual situation in order to assess the recoverable loss. The performance of the reference portfolio can be assessed in various manners. For instance, assume that an asset manager breached contractually agreed guidelines that state that between 75 percent and 85 percent of the portfolio should be invested in bonds, while at least 15 percent to at most 25 percent should be invested in stock. At the start of the contract, 20 percent is therefore invested in stock, 80 percent in bonds (T1). As the stock market soars, however, the asset manager notes that whereas the bonds have yielded 2 percent, stocks increased with 25 percent in value. Hence, the asset manager increases the investments in stock to 25 percent of the portfolio, while bonds account for 75 percent of the portfolio's total value (T2). Spurred by the soaring stock prices however, the asset manager decides to double the stock investments, which now accounts for a little less than 50 percent of the portfolio (T3). However, as the stocks start to plunge shortly after, the portfolio starts to lose value in its stocks compartment (-20 percent), while the bonds have continued their steady growth (+2 percent). Realizing the breach that occurred upon studying the interim reports on the investments made on his behalf, the investor contacts the asset manager to complain. Dissatisfied with the service, the investor terminates the contractual relation within the next few weeks (T4) and files claim against the asset manager to recover the loss.

	T1		T2		T3		T4		Reference portfolio at (T4)	
	Value (€)	%	Value (€)	%	Value (€)	%	Value (€)	%	Value (€)	%
Stock	200.000	20%	250.000	25%	500.000	47%	400.000	41%	200.000	19%
Bond	800.000	80%	816.000	75%	566.000	53%	577.320	59%	832.320	80%
Total value	1.000.000		1.066.000		1.066.000		977.320		1.032.320	

275. In order to determine the value the hypothetical portfolio would have, the court could refer to the value the portfolio would have had, had the breach not occurred by simply looking how the portfolio would have evolved as it was composed in the period before the breach took place and would have performed over time.[973] To assess the recoverable loss, the court would have to compose a reference portfolio in which the erroneous duplication of stock investments at (T3) is omitted and calculate the performance of the portfolio based on an unaltered composition. In the example, the reference portfolio would have a total value of €1.032.320 at T4, which implies a recoverable loss of €55.000 (€1.032.320-€977.320).[974] Alternatively, courts may also use on a range of possible alternative investments that qualify as suitable or representative to assess the performance of the hypothetical reference portfolio, and refer to the average outcomes of those investments or portfolios.[975] Relevant alternative investments are generally selected based on the type of securities involved (bonds, stock, derivatives etc.) and a risk level corresponding to the investor profile. Additionally, rather than using only one or a few alternative investments or funds aimed at similar profiles, the average performance of a range of comparable alternative investments can be employed as reference to preclude arbitrariness and unwarranted results.[976] It is repeated that courts or parties can call upon experts to assess the recoverable loss, using these methods.

276. **The role of benchmarks and indices.** – Another option to assess the recoverable loss may be involve benchmarks or indices.[977] For instance, a requirement to include a benchmark – such as a reference index[978] or a theoretical comparative portfolio[979] – in asset management contracts was introduced under MiFID and may serve as a yardstick for the investor-client to assess and evaluate the performance and portfolio evolution.[980] However, it is underlined that mere deviations from the benchmark are not sufficient to spur liability as (evidence of) a breach which caused the portfolio to do worse than the benchmark is invariably required in order to hold asset managers liable.[981] It is

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[973] For an example: Rb Amsterdam, 11 March 2009, LJN BH6081, *RF* 2009, 76.

[974] Examples to calculate the performance of the hypothetical portfolio performance are also elaborated and illustrated in TOXOPEUS-DE VRIES, 'Het begroten van beleggingsschade', 244 ff.

[975] ROSAT, *Der Anlageschaden*, 103; the latter considers this abstract method preferable to the aforementioned approach too arbitrary because it reduces the basis for comparison to a very limited number of alternative investments.

[976] BALZER, 'Vermögensverwaltung', 1496, para. 52; CASPER and ALTGEN, 'Germany', 126, para. 4.126.

[977] For an example, see also: TOXOPEUS-DE VRIES, 'Het begroten van beleggingsschade', 241, using indices to assess the loss.

[978] E.g. (Belgium) Kh. Brussel, 3 February 2011, *DAOR* 2012, iss. 102, 222 with ann. by G. LAGUESSE.

[979] E.g. (Belgium) Brussel, 9 February 2012, *DAOR* 2012, iss. 102, 235; or (France) CA Paris, (15th Ch.), 20 October 2006, jurisdata 2006-32393, (SA Sedec Finance/X).

[980] Art. 30 (2) Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards Organizational Requirements and Operating Conditions for Investment Firms and Defined Terms for the Purposes of that Directive, *OJ* L 241/26 ('MiFID Implementing Directive'): "Member States shall ensure that, when providing the service of portfolio management, investment firms establish an appropriate method of evaluation and comparison such as a meaningful benchmark, based on the investment objectives of the client and the types of financial instruments included in the client portfolio, so as to enable the client for whom the service is provided to assess the firm's performance." For a similar point of view regarding the impact of benchmarks on the assessment of fault in courts: (Belgium) Brussel, 9 February 2012, *DAOR* 2012, iss. 102, 235; See also: KRUITHOF, 'Privaatrechtelijke remedies', 176, ftn. 80; DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 243-248. *Comp.:* S. DUERINCKX, "Het foutcriterium bij overeenkomsten van vermogensbeheer in het licht van de benchmark-verplichting, annotation of Brussel 19 February 2008, *RABG*, 2009, iss. 15, 1070. (Germany) SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §5, para. 31; (Switzerland) THÉVENOZ and BRETTON-CHEVALLIER, 'Switzerland', para. 10.72.

[981] (Belgium) Rb Brussel, 3 October 2011, *THB* 2013, afl. 7, 624 at 631: "Le referential ou "benchmark" don't les parties ont convenu pourra servier à mesurer le préjudice. Le client dont le portefeuille n'a pas atteint le même niveau de performance ne pourra toutefois pas prétendre à une indemnisation automatique et proportionée."); Kh. Brussel, 3 February 2011, *DAOR* 2012, afl. 102, 222 with ann. by G. LAGUESSE. *Comp.:* S. DUERINCKX"Het foutcriterium bij overeenkomsten van vermogensbeheer in het licht van de benchmark-verplichting, annotation of Brussel 19 February 2008, *RABG* 2009, afl. 15, 1070. (Germany) SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §5, para. 31. In case however a financial advisor guarantees in an investment proposal that there is no risk to lose the investment capital, the advisor has guaranteed the initial

commonly understood that the manager's actions and decisions must be evaluated without the benefit of hindsight and that performances below the benchmark do not constitute wrongful conduct as such.[982]

This is however not to say that benchmarks have no relevance at all with regard to investor suits. Besides the fact that benchmarks enable investors to evaluate and signal problems in case considerable differences arise between the benchmark and the portfolio evolution, benchmarks have also proven to play a role in the assessment of the damages once a breach has been established. For instance, in a decision handed down by the Court of First Instance in Amsterdam concerning a breach of contractually agreed terms by an asset manager, the court illustrated how a benchmark may serve as an indication for the calculation of damages.[983] The investor-claimants had chosen to invest in shares with an average risk degree in terms of geographical and sector diversification. As the agreed level of diversification had been exceeded, resulting in an increase of risk, the court considered the asset manager liable for the loss resulting from the breach. The claimants demanded damages equal to the difference between the actual suffered loss and the MSCI World Index since the latter had been set as a benchmark to evaluate the portfolio evolution. Considering that the inclusion of a benchmark implies an obligation to perform with best efforts though without guaranteeing a certain result, the court considered the comparison with the benchmark inappropriate. Moreover, in stating the outperformance of the MSCI World Index as an objective in the contract, the parties had unambiguously chosen for a different portfolio composition, which implies the chance to do better than the index but also the risk to do worse. The court hence decides to assess the damages by reference to the index, though not without applying a margin to take the discretionary mandate assigned to the defendant into account. The margin was set at 20 percent – in accordance with the principle of equity, fairness and reasonableness – resulting in a recoverable loss equal to the difference between actual value decline and index evolution, reduced with 20 percent.[984]

277. Comparative overview. – Index evolutions have been accepted in varying degrees in the context of damages assessment in the Member States. In the Netherlands for instance, it is not uncommon to refer to index evolutions to take the impact of general market tendencies into account when measuring the recoverable loss.[985] In Germany on the other hand, courts and literature seem more wary of indices and deem the use of indices appropriate only in case intended investment(s) or

capital is safeguarded and will be held liable to the extent the initial capital loses value. Gent, 15 October 2003, *RABG* 2005/04, 285 with ann. by S. DELAEY.

[982] Idem.

[983] Rb Amsterdam, 9 June 2004, *JOR* 2004/242, (Driessen e.a./Delta Lloyd Bank NV), with ann. A.R. FILIUS.

[984] *Comp.*: Kh. Brussel, 3 February 2011, *DAOR* 2012, afl. 102, 222, with ann. by G. LAGUESSE. In the latter a margin of 2 percent deviation from the reference indices was allowed to assess the loss caused by employing a more offensive strategy than the contractually agreed defensive strategy.

[985] Rb Amsterdam 9 June 2004, *JOR* 2004/242 with ann. by A.R. FILIUS; Rb Amsterdam 7 March 2012, *JOR* 2012/216; Rb Amsterdam 14 December 2011, LJN BV9739, available at www.rechtspraak.nl; Rb Amsterdam 24 January 2007, *JOR* 2007/94, (Laan e.a./Wijs & Van Oostveen BV), with ann. by F.M.A. T'HART; In the latter decision, the loss was assessed by using a reference portfolio with a diversified investment strategy as the court considers would have been applied by a reasonably prudent asset manager. Since a total index decline of 46,30 percent had taken place on the AEX index, the claimed losses equal to the amount that would have been invested in AEX-stocks was reduced with a percentage of 46,30 percent, while the investments that would have been made in real estate were increased with 25,70 percent and the bonds with 58,42 percent, corresponding to the evolutions that took place on the respective markets. Hof Amsterdam, 27 April 2010, *JOR* 2010/161, (van den Bogaert/ABN Amro Bank NV); Rb Amsterdam 21 December 2011, *JOR* 2012/81, (X/Wealth Management Partners NV). See also: BUSCH and SILVERENTAND, 'The Netherlands', 238, para. 7.159 and references cited (ftn. 261); VAN LUYN and DU PERRON, *'Zorgplicht'*, 282. Similar: VAN BAALEN, *Zorgplichten*, 272.

reference portfolio corresponds to the securities listed in the index.[986] In the context of asset management or advice, portfolios with a composition similar to a particular index occur in the context of passive investment strategies, i.e. when the investment objective is to obtain a return approximating the index evolution. This point of view suggests that index evolutions are mostly relevant when passive strategies are employed.[987] Yet in France, courts have made references to indices as a general indication to assess and compare the results obtained with particular investments and investment strategies.[988] Overall, it seems clear that insofar representative indices are available, they may prove useful to assess the recoverable loss, especially when treated with causation as in the aforementioned example of the Dutch case brought before the Amsterdam Court of First Instance (*supra* para. 276).[989]

278. Determination of the relevant index – The choice of the index is obviously relevant, since sector specific indices (such as e.g. Nasdaq 100) may for instance render different results compared to more general indices (e.g. Dow Jones). Similarly, geographic factors may play a role since national indices (e.g. DAX, AEX, Nikkei 300, SMI or FTSE) may produce substantially different results compared to each other or compared to international indices (e.g. MSCI World, S&P Global 100 Index, Euro Stoxx 50). Another element to take into account is the type of securities that would have been traded and may render bond market indices better suited than stock market indices, depending on the type of instrument. Hence, when assessing the hypothetical performance of a fictitious portfolio composed of different type of instruments, it is evident that the index used to assess the outcome of the part invested in shares is different from the one used with regard to bonds.[990]

279. In certain instances courts have found sufficient indications justifying the reference to index evolutions. In cases where the financial service provider had set a certain benchmark in the form of an index, courts have been found to use that index as a reference point to assess the recoverable loss.[991] In other instances however, the reason to choose a particular index as (the most) representative or relevant measure to assess the loss, are not as apparent from the decisions. In a decision of the Amsterdam court of first instance for example, the relevant index to measure the hypothetical result of the fictitious portfolio with regard to funds allocated to shares was disputed.[992] Reasoning that a more diversified portfolio would have been more suitable than a portfolio consisting of mainly AEX-stock, the court held that the MSCI World Index was more appropriate, as the claimant had suggested. The particular reason why the MSCI is suitable in the given case, other than a more diversified allocation compared to the AEX index, is not mentioned.[993] In other cases, the use of indices such as the AEX was rejected upon finding that the suggested index was not appropriate in the light of the strategy or

[986] OLG Stuttgart, 20 April 2011, *WM* 2012, Heft 36, 1723. See also: SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1745; CASPER and ALTGEN, 'Germany', 127, para. 4.128 with reference to OLG Hamm, OLGR Hamm, 1998, 286.

[987] (UK) VAN SETTEN, *'The law of institutional investment management'*, 122; (Germany) BENICKE, *Wertpapiervermögensverwaltung*, 847.

[988] See below, para. 280.

[989] Rb Amsterdam, 9 June 2004, *JOR* 2004/242, (Driessen e.a./Delta Lloyd Bank NV), with ann. A.R. FILIUS.

[990] Rb Amsterdam 14 December 2011, LJN BV9739, available at www.rechtspraak.nl; Rb Amsterdam 7 March 2012, *JOR* 2012/216. ROSAT, *Der Anlageschaden*, 110.

[991] Rb Amsterdam 9 June 2004, *JOR* 2004/242 with ann. by A.R. FILIUS; Court of First Instance Amsterdam, 21 December 2011, *JOR* 2012/81, (X Holding BV/WMP NV). For instance, seeking a relevant index that may apply to bond investments by an investor with a defensive profile, TOXOPEUS-DE VRIES notes that the EFTAS EUR GOV Bonds Index may be used as a reference, while the MSCI World Large and Mid Cap Index may be useful when seeking an index that represents shares in large and mid cap companies on a global basis. TOXOPEUS-DE VRIES, 'Het begroten van beleggingsschade', 243-244.

[992] Rb Amsterdam 7 March 2012, *JOR* 2012/216.

[993] *Comp*.: Rb Amsterdam 14 December 2011, LJN BV9739, available at www.rechtspraak.nl.;

investment policy agreed on.[994] Yet other examples show a more questionable connection between the choice of index and the assessment of the damages. Awarding damages for the loss suffered due to the KYC-rules, the Amsterdam court of first instance tied the measurement of the damages to the evolution on the AEX index in the relevant time period, reasoning that since it concerned a Dutch investor, it appeared reasonable to assume that AEX-listed shares would have been invested in.[995]

280. Although indices should be determined in the light of their representativeness in the light of the investment concerned[996], national preferences appear to have an even more notable impact in France. French courts have repeatedly made reference to the French CAC 40, though generally without offering further explanations or motivations as to the reason to choose that particular index.[997] The use of an index to assess the loss is however very diffuse and inconsistently employed by the French courts.

Some decisions explicitly reject to take the index evolution (in practice invariably the CAC 40, or so it seems) into account, reasoning that the defendant is only required to execute the given mandate with due care and prudence, and not to match (or beat) the result obtained by the index.[998] Yet in another decision by the very same court it was held that even though the defendant is only required to execute his mandate with due care and prudence without guarantees as to the result, this did not preclude the court from using the CAC 40 as a reference to assess the loss.[999] The court concluded that a normally prudent and circumspect asset manager would have achieved a result (at least) comparable to the general index evolution (i.e. CAC 40). The court does not advance facts or indications supporting this latter assertion. Other court decisions as well show references to index evolutions without reservation in order to assess the recoverable loss, either to the benefit or detriment of the investor-claimant. For instance, observing that the decline in investment value matched the fall of the CAC 40, the court held that no recoverable loss existed.[1000] Yet in other, similar decisions, damages were awarded upon finding that the investment lost a considerably part of its initial value while no similar evolution could

[994] For instance: Hof Amsterdam, 30 September 2008, (Schoonhoven/NNEK), *JOR* 2008/312, r.o. 4.20. Holding that the client's investment guidelines and objectives were not exclusively aimed at securities listing on the AEX, the court did not consider the latter index evolution relevant as a reference point to calculate the damages.

[995] Rb Amsterdam 24 January 2007, *JOR* 2007/94, (Laan/Wijs & Van Oostveen BV), with ann. by F.M.A. 'T HART; Hof Amsterdam, 27 April 2010, *JOR* 2010/161(van den Bogaert/ABN Amro Bank NV).

[996] (Belgium) Brussel, 19 February 2008, *TBH* 2012, iss. 2, 148; *RABG* 2009, iss. 15, 1070, with ann. by S. DUERINCKX; the court rejected to take the index evolutions of the Bel20 or MSCI World Index into account as the indices were not considered relevant in the light of the strategy and investment chosen by the investor. The latter had opted for a high degree of risk and rather limited diversification with a preference for investments in the technology sector (up to 60 percent). The aforementioned indices do not match this strategy since the MSCI World Index is composed of considerably more shares and is more diversified over the various economic sectors, while the Bel20 was considered equally irrelevant given its specific character according to the court. See also F.M.A. T'HART for a similar remark: Rb Amsterdam 24 January 2007, *JOR* 2007/94, (Laan/Wijs & Van Oostveen BV), with ann. by F.M.A. 'T HART.

[997] CA Paris, (15th ch.), 11 May 2006, jurisdata 2006-310355, (SA Crédit Lyonnais/Soc. SCIA); CA Paris, (15th ch.), 11 January 2002, jurisdata 2002-166314, (STE UBS Warburg/Agliany); CA Paris, (15th Ch.), 2 October 2001, Jurisdata 2001-160531 (Wargny/X.); CA Angers, 31 May 2011, jurisdata 2011-015101, (Le Crédit Lyonnais/Martin); in the latter case, the loss had been suffered with regard to an investment in particular shares (Eurodisney). To assess the hypothetical outcome of a more suitable investment, the court referred to the evolution on the CAC40 and awarded the difference between the actual result and the result of the index as damages (after deducting the residual value of the shares); CA Paris (1st ch.), 2 October 2001; CA Versailles, 15 December 2005, *Bull. Joly Bourse*, 2006, 53, §5, with ann. L. RUET. In this case, 100 percent of the investment had been invested in French shares, which may explain the reference to the CAC 40.

[998] CA Paris, (1st Ch.), 19 May 1998, Jurisdata 1998-021317, (Wargny/Riant).

[999] CA Paris, (15th ch.), 11 January 2002, jurisdata 2002-166314, (STE UBS Warburg/Agliany). See in this regard also: BONFILS, *Le droit des obligations*, 213.

[1000] CA Paris (5th Ch.), 11 February 2010, *Bull. Joly Bourse* 2010, 255, §233, (Pillet/HSBC France) with ann. by L. RUET. The latter notes tough that the declines did not really match as the court asserted. Whereas the investment had lost 34 percent to its initial value, the CAC 40 lost 28,8 percent over the same time period.

be observed on the CAC 40.[1001] Overall, the relevance of indices in the process of damages assessment by French courts remains fairly blurred as a result of conflicting and remarkably vague decisions in this regard.[1002]

281. Damages estimated 'ex aequo et bono'. – Finally, acknowledging the difficulty in assessing the recoverable loss in a precise matter, courts have resorted to estimates based on the principles of reasonableness and fairness. In a recent Belgian decision for instance, the court held that in absence of the deficient advice, it could be assumed that the claimant would have invested the funds in a more conservative manner.[1003] As a result, the loss would have been limited to some extent, though not entirely, nor was it realistic to assume that in a context of deteriorating market conditions any return would have been yielded with alternative investments. Hence, the court awarded a fixed amount of damages.[1004] A more or less identical decision was handed down by the Paris appellate court. The court particularly refused to award damages equal to the initial investment considering that losses suffered due to market risks are inherent to investment activities and must be borne by the investor.[1005] Although an assessment '*ex aequo et bono*' may be helpful in some instances, it should remain a court's last resort, especially since the previous paragraphs offered more precise and tailored methods to assess the losses. As the method to assess the recoverable loss invariably contains hypothetical elements, the outcome cannot be assessed with absolute certainty. The methods explained in the previous paragraphs may however serve as guidelines to approximate the result that would have been obtained.

4. Procedural and evidential aspects

282. As clarified in the previous chapter, the burden of proof with regard to the existence and scope of the loss is normally on the claimant.[1006] In case it has been established that loss has emerged as a result of the wrongdoer's fault, however, courts are required to assess the loss and cannot dismiss the claim if the claimant fails to provide evidence on the scope of the loss.[1007] In these cases courts can ultimately resort to an assessment based according to the principles of fairness and reasonableness ('*ex*

[1001] Trib. Comm. Paris, (7th Ch.), 8 October 2002, Jurisdata 2002-196497, (Dana/Société Discount Bank). Whereas the investment had suffered a value decline of 36 percent compared to its initial value, no similar effect was noted with regard to the CAC 40. Similarly: CA Paris, (15th ch.), 11 May 2006, jurisdata 2006-310355, (SA Crédit Lyonnais/Soc. SCIA); Whereas the index (CAC 40) held 65 percent of its initial value, the portfolio only held 40 percent.

[1002] BONFILS suggests that the confusing state of the case law in this regard is partially due to the rather low standards set by the French Court de Cassation concerning the assessment of damages. BONFILS, *Le droit des obligations*, 213. In a similar sense: SPITZ, *La réparation*, 210, para. 333. See for an illustration also: CA Versailles, 15 December 2005, *Bull. Joly Bourse*, 2006, 53, §5, with ann. L. RUET. In this decision the Versailles appellate court confirmed the tribunal's point of view that damages were to be measured in reference to the evolution of the CAC 40. The court however did not mention how the damages had been calculated nor to what extent the index evolution had been used in that regard. No other relevant details were provided either, such as the loss claimedor the amount initially invested for example. The decision was confined to the statement that the portfolios had lost value in a more substantial degree (-70 percent, -61 percent and -52,5 percent) than the CAC 40 (-50 percent). The court held that in case a more suitable management had been carried out, the plaintiffs might have suffered loss to a lesser extent, comparable to the evolution observed by the CAC 40. Without providing any further details, the court decides that the damages awarded by the court of first instance are confirmed in appeal. To what extent the index played a role in setting the damages, the claimed losses and the initial investment amount provided by the claimants remains unknown. The annotation (rightfully) criticizes the decision on this point (L. RUET: CA Versailles, 15 December 2005, *Bull. Joly Bourse*, 2006, 53, §5). See in this regard also: BONFILS, *Le droit des obligations*, 212 ff.

[1003] Rb Brussel, 24 February 2012, *Bank. Fin. R.*, 2012/II, 128.

[1004] [1004] Rb Brussel, 24 February 2012, *Bank. Fin. R.*, 2012/II, 128. See also: Kh. Brussel, 24 April 2013, *TBH* 2013, 174. *Comp*. CA Paris, (6th Ch.), 24 September 2010, jurisdata 2010-019848, (*Ferret/SA Banque Privée*).

[1005] CA Paris, (25th Ch.), 26 November 1999, jurisdata 112572, (Zecchinon/Claussmann Salomon).

[1006] See *supra*, para. 169 ff.

[1007] See *supra*, para. 170.

aequo et bono').[1008] As noted the previous section, alternative investments that the investor-claimant may have chosen in absence of the wrong are not taken into account with regard to breaches of precontractual information duties or erroneous advice, according to German law.[1009] To the extent the wrongful act concerns a contractual breach in the execution of asset management contracts however, such as non-compliance with agreed investment guidelines, a comparison with an alternative course of actions is allowed.[1010] In the latter case, it is left to the defendant to present evidence that losses would not have been suffered (to a similar extent) absent the wrong.[1011] The latter must prove that an alternative investment would have been made and that (part of) the loss would invariably have been suffered in this alternative investment as well. Absent such evidence presented by the financial service provider, investors recover the initial investment amount in return for the instruments, or the difference between the initial investment amount and the residual value of the securities.[1012]

5. Interim conclusion

283. This section aimed to clarify how courts can reconstruct the hypothetical scenario in which no wrongful behavior occurred, and the outcome that would most likely have been obtained. As the method to assess the recoverable loss invariably contains hypothetical elements, the outcome cannot be assessed with absolute certainty. The methods explained in the previous paragraphs may however serve as guidelines to approximate the result that would have been obtained. By means of the reconstruction of a reference portfolio, a credible alternative scenario is developed that offers a means to assess the hypothetical outcome that would (probably) have been obtained absent the wrong. Depending on what method suits best in a particular case, various methods were presented to calculate the loss. Whereas the composition of funds targeted at investors with similar profiles, or standard or reference portfolios ('*Musterportefeuilles'* or '*normportefeuilles*') used by professional financial service providers can serve as a model for courts to assess the loss in a given situation, the employment of indices may be more confined to those situations where the indices actually match or approximate the composition of the (hypothetical) reference portfolio to a considerable degree. Employment of assessments '*ex aequo et bono'* on the other hand should be confined to a minimum as these assessments are less precise and may allow for some arbitrariness and divergence between court decisions. As various techniques can be employed to assess the recoverable loss, assessments '*ex aequo et bono'* should serve as a courts last resort.

[1008] See *supra*, paras. 170 and 281.

[1009] See *supra*, para. 264.

[1010] Idem. See also the references cited in ftn. 947.

[1011] SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, 434, §21, para. 87; BENICKE, *Wertpapiervermögensverwaltung*, 836-837, 854. Benicke notes that given the difficulty to produce evidence in this regard, defendants often not even attempt to do so (p. 832); BAMBERGER, 'Anlageberatung', 1471, para. 203; GEIBEL, *Der Kapitalanlegerschaden*, 158 ff.; BALZER, 'Vermögensverwaltung', 1497, para. 54; CASPER and ALTGEN, 'Germany', 124, para. 4.117; VELDHOFF, *Die Haftung von Kreditinstituten*, 321.

[1012] See for instance: OLG Hamm, 28 December 1995, *WM* 1996, (669) 672, assessing the recoverable loss, the court sets out that the initial investment value must be reduced with the residual value of the portfolio, then deducts the undisputed repayment of 5.000 Deutsche Mark ('DM'), and finally reduces the amount with 5.223 DM since that is the amount that corresponds with the loss suffered from a decline in value in the 20 percent properly invested funds in the relevant period. The other 80 percent of the loss was caused by investments that were considered wrongful in the light of the client's profile and objectives and to be compensated for by the defendant-asset manager. The court does not compare the outcome of the wrongful investments with any other investment that may have served as a plausible and proper alternative. See for other examples: OLG Karlsruhe 16 March 2000, *ZIP* 2000, heft 46, 2060; *WM* 2001, heft 16, 805**.** *Comp*. with the point of view expressed by the Swiss BGE in a medical liability case: BGE 28 September 2005, 4C.156/2005, *SJ* 2006, I, 122, consid. 3.5.6. See also on the Swiss debate on what party bears to the burden of proof regarding the hypothetical alternative scenario: CHAPPUIS, 'Détermination du dommage', 103.

C. Alternative methods to assess recoverable investment loss: loss of a chance

1. Overview

284. Courts in various jurisdictions have resorted to the doctrine of the loss of a chance to overcome uncertainty in the assessment of causation and recoverable loss in the context of investor suits. Most notably in France, the theory has developed into the standard approach to investor suits by courts, including the French Supreme Court.[1013] In other jurisdictions such as Belgium and Luxembourg courts have also employed the theory of the loss of a chance, yet substantially less court decisions have been reported in comparison to France.[1014] Yet in other jurisdictions, such as Germany and the UK, courts have remained rather reluctant to accept the doctrine of the loss of a chance as a serviceable solution to causal uncertainty, including cases on investor compensation.[1015] In the previous chapter, the doctrine of the loss of a chance was discussed from the angle of transaction causation, implying that courts apply the loss of a chance doctrine to assess the chances that the investor would have made another investment decision. Yet, the loss of chance doctrine has not only been applied to assess transaction causation, but has also been employed to assess the *quantum* of the recoverable loss. More particularly, assumed that there is a real and reasonable chance that investors would have made another investment decision, it remains uncertain whether the alternative investment would have led to a better outcome and what that outcome would have been. Hence, this section discusses the assessment of investor losses and more particularly investigates which factors are decisive in assessing the monetary value of the lost chance to invest in a more suitable or correct manner.

2. Assessment of the chance lost to the aggrieved investor

285. It was already explained in the previous chapter that according to the loss of a chance doctrine the recoverable loss comprises the chance lost to the investor-claimant to obtain a better result than the

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[1013] Court decisions taking resort to the loss of a chance doctrine in France are ample. For some examples, see amongst many others: Cass. Com., 10 December 1996, (*France Compensation Bourse/Chevalier*), *Bull. Joly Bourse*, March-April 1997, 205-207, comment by H. DE VAUPLANE, 209-212; CA Paris, 1th Ch., 25 January 2008, Jurisdata: 2005-358592, (*X./Soc. ODDO & Co*.); the latter appellate decision was confirmed in: Cass., comm., 15 September 2009, Jurisdata 2009-049496, (*X./ Soc. Oddo & Co*). CA Paris, 4th Ch., 18 May 2011, *Rev. Banc. Fin.*, 2011, nr. 4, Juillet, comm. 150 with ann. by I. RIASSETTO; CA Paris, (15th Ch.), 2 October 2001, Jurisdata 2001-160531 (Wargny/X.); CA Angers, 31 May 2011, jurisdata 2011-015101, (*Le Crédit Lyonnais/Martin*); CA Paris, (15th Ch.), 20 October 2006, jurisdata 2006-32393, (*SA Sedec Finance/X*); CA Rennes, 1st Ch., 23 October 2008, Jurisdata 2008-005000, (*Merlet/SA Soc. Gen*.); CA Paris, 15th ch., 29 May 2008, Jurisdata 2008-366770, (*Leclerc/SA Banque Neuflize OBC*). See also: TANDEAU DE MARSAC, *La responsabilité des conseils*, 126-127; MULLER, 'Dernières décisions relatives à la responsabilité des professionnels', comm., 74; RIASSETTO, 'OPCVM monétaires et crise des "subprimes": responsabilité civile des acteurs', 150; BONHOMME, 'Responsabilité et gestion du risque financier', étude 31; COURET, GOUTAY and ZABALA, 'France', 85, para. 3.116.

[1014] For Belgian examples, see for instance: Court of Appeal Bergen, 7 October 2004, *Bank. Fin.* R. 2006/II, 94, with ann. by S. DELAEY.; Rb. Brussel, 24 February 2012, *Bank. Fin. R.*, 2012/II, 128; Rb. Mechelen, 3 April 2001, *R.W.*, 2005-2006, nr. 3, 111. See also: ROGER and SALMON, 'Réflexions relatives à la responsabilité contractuelle', n°53-56; VAN OEVELEN, 'Contractuele en buitencontractuele rechtsbescherming', 127; F. LONGFILS, *La responsabilité des intermédiaries financiers*, Waterloo, Kluwer, 2006, 67, para. 203.

[1015] For comparative overviews, consult: GRAZIANO, 'The "loss of a chance" in European Private Law', (123) 133-139; N. JANSEN, 'Loss of a Chance', B. WINIGER, H. KOZIOL, B.A. KOCH and R. ZIMMERMANN, *Essential Cases on Natural Causation*, Wien, New York, Springer, 2007, 454-592; L. KHOURY, 'Causation and risk in the highest courts of Canada, England and France', 124 *LQR*, 2008, 103-131; FAIRGRIEVE and G'SELL-MACREZ, 'Causation in French law', 124. In the Netherlands on the other hand, a similar doctrine has been employed and is generally referred to as the doctrine of proportional liability. As this theory assess the probability that the wrong caused the loss, the Dutch doctrine of proportionality was discussed in the previous chapter (see *supra*, para. 228) one actually realized, as a result of the wrongdoer's fault.[1016] It was particularly clarified that under the loss of a chance doctrine, investors are not compensated for the investment loss as such, but for the foregone chance to avert incurring such losses by choosing a more suitable (i.e. often less risky) investment or strategy.[1017] As a result, the scope of the damages awarded for a foregone chance depends on the likelihood that the loss would have materialized in absence of the misconduct. The more probable that another investment would have been chosen and the more probable that the loss would not have been incurred with that alternative investment, the more the investor will recover. Yet, it has been firmly established in the French case law that compensation for the loss of a chance cannot equal the benefit that would have been accomplished without the wrongdoing.[1018]

286. The theory underlying the loss of a chance doctrine is straightforward and clear. In practice, however, the question has invariably arisen how to quantify the likelihood that the loss would not have occurred (to the same extent). Confronted with questions and difficulties in quantifying the pecuniary value of the chances lost on investors, courts have employed different techniques. A recurrently used technique in this regard relates to reference indices and was discussed to some extent in the previous section already.[1019] It was noted that French courts have repeatedly referred to the evolution of a relevant index (generally the CAC 40) to assess the chance that a claimant would have achieved a better result with a better suited investment.[1020] Yet in other instances, courts have assessed the recoverable loss in the light of general market tendencies without express references to indices or other objective standards to measure the impact of those market tendencies. The assessment of recoverable loss in terms of concrete numbers, if possible at all, is generally not mentioned.[1021] Instead, the recoverable loss is recurrently measured in the light of the principles of fairness, reasonableness and equity ('*ex aequo et bono'*), which are mostly mere estimates based on discretionary assessments by courts.[1022] For example, considering that it was uncertain whether the investor-claimants would have chosen a more suitable investment had they been duly informed, and that the investors themselves had been negligent when they remained silent for a period of six years after they saw that the portfolio was losing considerable value, the court fixes the recoverable loss on €10.000 without further ado.[1023] Along similar lines, the Bergen appellate court considered a claim for losses allegedly due to a lack of diversification in the portfolio and held that the chance to obtain a better result with a higher level of

[1016] See *supra*, Part II, Chapter I, para. 226.

[1017] See for instance: I. Riassetto, OPVCM monetaires et crise des subrpimes: responsabilite des acteurs, *Rev. Banc. Fin.*, 2011, nr. 4, Juillet, comm. 150 (comment by CA Paris, 18 May 2011); KHOURY, 'Causation and risk', 113; BONFILS, *Le droit des obligations*, 217.

[1018] The principle of partial compensation in the context of the loss of a chance has been confirmed on various occasions by courts applying the theory. See for instance with regard to the French case law: Cass., civ., 9 April 2009, *Bull. civ.* 2009, II, n° 98, (*Rollet/caisse d'allocations familiales de Lyon*); Cass. Com., 10 December 1996, (*France Compensation Bourse/Chevalier*), *Bull. Joly Bourse*, March-April 1997, 205-207, with ann. by H. DE VAUPLANE, 209-212; *P.A.* 1997, n° 15; Cass., civ., 9 April 2002, *Bull. Civ.* 2002, I, no. 116; Cass., civ., 12 September 2012, jurisdata 2012-020068, unpublished; Cass., civ., 4 May 2012, jurisdata 2012-009157, (*Les Souscripteurs du Lloyd's/ Duthion et alia*), unpublished; Cass., civ., 4 November 2003, *Bull. Civ.* 2003, I, no. 224; CA Paris, (15th Ch.), 2 October 2001, Jurisdata 2001-160531 (*Wargny/X.*); CA Riom, 2 July 2012, civ., jurisdata 2012-014738, (*Martinet/SA Generali Vie*); CA Paris, 15th ch., 29 May 2008, Jurisdata 2008-366770, (*Leclerc/SA Banque Neuflize OBC*). Belgium: Cass., 17 December 2009, *RW* 2011-12, nr. 33, 1; *NJW* 2010, 660, with ann. by I. BOONE, *RGAR* 2010, nr. 14.633; *TBH* 2010, 278. See also: BOCKEN and BOONE, *Schadevergoedingsrecht*, 56.

[1019] See *supra*. para. 280.

[1020] Idem.

[1021] CA Paris, (15th Ch.), 20 October 2006, jurisdata 2006-32393, (SA Sedec Finance/X); CA Rennes, 1st Ch., 23 October 2008, Jurisdata 2008-005000, (*Merlet/SA Soc. Gen*.).

[1022] Idem. Bergen, 7 October 2004, *Bank. Fin.* R. 2006/II, 94, with ann. by S. DELAEY. See also: Rb. Brussel, 24 februari 2012, *Bank. Fin. R.*, 2012/II, 128. See also: VANDENDRIESSCHE, 'Causaliteit en bewijslast', 202 and 207.

[1023] CA Rennes, 1st Ch., 23 October 2008, Jurisdata 2008-005000, (*Merlet/SA Soc. Gen*.). The loss claimed by the investors amounted to €51.392.

diversification could not be mathematically calculated.[1024] The court estimated the chance on a better outcome around 50 percent and awarded damages for half of the investment loss suffered.

Summarized, the concept of liability for damages proportional to the likelihood that the loss was caused by the defendant' fault essentially shifts the problem from uncertainty in the assessment of causation to the level of damages calculation. It also seems that the lack of indications and uniform methods to assess the loss under the doctrine of the loss of a chance allows for a considerable degree of uncertainty and arbitrariness in court decisions.[1025]

IV. Limits on investor compensation

287. Once courts have determined the loss suffered as a result of the wrongdoer's fault, some corrections or adjustments may apply in the light of the investor's own responsibility for the emergence of the loss (contributory negligence) and/or accumulation of the loss (mitigation of the damages). Contributory negligence and the obligation to mitigate the loss are defenses that may be raised by the defendant, provided the latter succeeds in establishing proof in that regard. A third potential correction concerns the netting of the loss with the gains investors may have enjoyed as a result of the wrongful behavior.

A. Contributory negligence

1. General overview

288. The concept of contributory negligence ('*eigen schuld'*, '*faute concomitante'*, '*Mitverschulden'*, or '*Selbstverschulden'*), implies that when a plaintiff has contributed to the emergence of the loss as a result of his own negligent behavior, the damages may be apportioned.[1026]

[1024] Belgium: Bergen, 7 October 2004, *Bank. Fin.* R. 2006/II, 94, with ann. by S. DELAEY. See also: Rb. Brussel, 24 februari 2012, *Bank. Fin. R.*, 2012/II, 128. See also: VANDENDRIESSCHE, 'Causaliteit en bewijslast', 202 and 207.

[1025] Similar: CLERC, 'La réparation du préjudice', 37; SPITZ, *La réparation*, 325-326; D. SCHMIDT, 'Affaire Sidel: l'indemnisation des actionnaires', *Rec. Dalloz*, 2006, n° 36; D. MARTIN, 'La réparation du préjudice des investisseurs en case de fausse information', *JCP-E*, 2010, no. 36, Septembre, 1777. See in this regard also: RAVELINGIEN, Privaatrechtelijke handhaving, para. 687-688; and ARONS, *Cross-border Enforcement*, 136; BUSCH and SILVERENTAND, 'The Netherlands', 234, para. 7.144.

[1026] For a comparative overview: N. JANSEN, 'Contributory Negligence (Contributory Conduct or Activity)', J. BASEDOW, K.J. HOPT and A.S. ZIMMERMAN, *The Max Planck encyclopedia of European private law*, Oxford, Oxford University Press, 2012, 401. For an extensive overview: U. MAGNUS and M. MARTÍN-CASALS (eds.), *Unification of tort law: contributory negligence*, The Hague, Kluwer, 2004, (300p.). Germany: §254 BGB; see for a general overview also: PALANDT (ed.), *Bürgerliches Gesetzbuch*, §254. With regard to investment services in particular: BALZER, 'Vermögensverwaltung', §51, 1497, para 55; BENICKE, *Wertpapiervermögensverwaltung*, 875-876. UK: consult para. 1 (1) of The Law Reform (Contributory Negligence) Act 1945 in which the apportionment of damages as a result of the victim's own fault is laid down: "*Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage*". See also: MCGREGOR, *McGregor on damages*, 94, para. 5-001; HARDER, *Measuring damages*, 129 ff. Specifically in the context of investment advice, consult: MCMEEL and VIRGO, *Financial advice*, 450, para. 18-02; VAN SETTEN, 'England and Wales', 364, para. 11.108. France: LE TOURNEAU, *Droit de la responsabilité et des contrats*, para. 1852 ff.; A.-C. MULLER, *Droit des marchés financiers et droit des contrats*, Paris, Economica, 2007, para. 302. See for an example: CA Paris, 15th Ch., 16 February 1996, Jurisdata 1996-020220. The Netherlands: art. 6:101 DCC; para. HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, 107 ff.; VAN LUYN and DU PERRON, *'Zorgplicht'*, 280; VAN BAALEN, *Zorgplichten*, 418. See for instance: Hof Leeuwarden, 29 November 2011, LJN BU6235, *RF* 2012, 25; Rb Amsterdam 24 January 2007, *JOR* 2007/94, with ann. by F.M.A. 'T HART, r.o. 5.12; Rb Amsterdam 11 March 2009, *RF* 2009, 76, (X./Drie Koningen Effecten B.V.). Belgium: A. DE BOECK, *Informatierechten en -plichten bij de totstandkoming en uitvoering van overeenkomsten*, Antwerpen, Intersentia, 2000, 216; DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 311; VAN OEVELEN, 'Contractuele en buitencontractuele

The negligent behavior on the side of the claimant may lead to a reduction of the damages or even the complete exclusion of compensation. Hence, contributory negligence is a (partial) defense for defendants and applies both in the context of tort and contract law.[1027] The concept of contributory negligence is founded on and justified by different principles and theories in the Member States, ranging from principles of equity, fairness and good faith, over principles of causation to deterrence and economic reasons.[1028] Regardless of the theoretical justification though, the concept is generally used and understood as an instrument to apportion the damages in cases where the claimant is found to have contributed to the loss due to his negligence.

2. Contributory negligence in the context of investment services

289. Contributory negligence. Overview. – In the context of investment services, contributory negligence is generally invoked by defendants holding that the carelessness and speculative behavior of the investor himself added to the risks he agreed to take, or the failure to correct errors by the investment firms. For instance, despite the defendant’s failure to warn or inform the investor-client adequately, investors also generally have a duty to make reasonable efforts to gather information and prudently assess and consider the risks involved with investment activities they may engage in.[1029] The decision handed down by the Brussels court of first instance offers a clear illustration.[1030] The case concerned a rather inexperienced investor who had sought financial advice. Suffering considerable losses on the investment, the investor filed claim stating that the investment she had been advised to on was unsuitable, while she had not been provided with adequate information on the risks either. Considering the case, the court found that the bank had indeed recommended an unsuitable investment, yet the investor had neglected to read the information provided to her on the investment. Should she have read the information, she might have realized the risks related to the recommended investment and made have chosen a less risky investment, more suited to her profile. Considering the fault on the side of the bank-advisor and the fault on the side of the investor, the court considers the bank-advisor liable, yet reduces the damages to which the investor is entitled because of the latter’s contributory negligence.

290. Overall, the responsibility of investors to ask for information and make reasonable efforts to be informed, which includes that the investor reads the information provided, verifies or inquires additional information in case something is unclear, has been recurrently stated in court decisions and

rechtsbescherming', 134. Switzerland: ROSAT, *Der Anlageschaden*, 164; THÉVENOZ and BRETTON-CHEVALLIER, 'Switzerland', para. 10.92.

[1027] JANSEN, 'Contributory Negligence', 401.

[1028] See on this topic also: (from a German perspective) BENICKE, *Wertpapiervermögensverwaltung*, 875-876; M. FAURE, 'Economic analysis of contributory negligence', U. MAGNUS and M. MARTÍN-CASALS, *Contributory Negligence*, The Hague, Kluwer, 2004, 233-256; MULLER, *Droit des marchés financiers*, para. 302. See also the references cited in ftn. 1026.

[1029] The Netherlands: See for instance the decision of the Amsterdam Court of First Instance holding that the investor engaging in options trading should have taken the time and effort to understand the risks involved. Rb Amsterdam 2 March 2011, LJN BP7515, (Vestering Beheer BV e.a./ABN Amro NV), *JOR* 2011/147. Belgium: VAN OEVELEN, 'Contractuele en buitencontractuele rechtsbescherming', 134. Gent, 23 May 2002, unpublished, available at http://jure.juridat.just.fgov.be; Rb Brussel, 24 February 2012, *Bank. Fin. R.*, 2012/II, 128; Kh. Brussel, 28 januari 2011, *Bank. Fin. R.*, 2011/VI, 363, para. 19 (An investor is entitled to rely on professional financial service providers, but that does not exempt him from his own duty of care.); Bergen, 7 October 2004, *Bank. Fin.* R. 2006/II, 94, with ann. by S. DELAEY. Germany: S.J. GEIBEL, *Der Kapitalanlegerschaden*, Tübingen, Mohr Siebeck, 2002, 455 ff.; the extent to which the investor-client is expected to make inquiries and inform himself also depends on his level of sophistication.

[1030] Rb Brussel, 24 February 2012, *Bank. Fin. R.*, 2012/II, 128.

scholarly literature in various legal systems[1031], with the notable exception of Germany, however. According to German law, contributory negligence is acknowledged and applied, yet the courts appear less demanding towards investors compared to various other jurisdictions.[1032] It has for instance been accepted in the case law that investors are entitled to rely on the advice and information provided to him by professionals, without the duty to verify the information or assess critically, even if the investor is rather sophisticated.[1033]

291. Other examples in which contributory negligence can be applied besides the duty to gather information on potential investments and the risks involved, include cases in which advice or warnings were ignored by investors[1034], or when they failed to provide financial service providers with incorrect or incomplete information on their preferences and objectives, risk acceptance, experience, income and so on.[1035] In *JP Morgan Bank (formerly Chase Manhattan Bank) v Springwell Navigation Corp.* for instance, the court explicitly considered the failure on the side of the (professional) investor-claimant to clearly set out the investment objectives at the start of the relation as one of the factors to be weighted in the application of the contributory negligence defense.[1036]

[1031] For an overview with regard to the application of contributory negligence in the context of asset management, consult the country reports in: BUSCH and DE MOTT (eds.), *Liability of asset managers*, (2012). See also: Belgium: VANDENDRIESSCHE, 'Causaliteit en bewijslast', 209. Kh. Brussel, 28 january 2011, *Bank. Fin. R*., 2011/VI, 363, para. 19; (Bergen, 7 October 2004, *Bank. Fin.* R. 2006/II, 94, with ann. by S. DELAEY. Kh. Brussel, 17 januari 2006, *TBH*, 2008, afl. 1, 87, noot F. Longfils. The Netherlands: VAN LUYN and DU PERRON, *'Zorgplicht'*, 279; VAN BAALEN, *Zorgplichten*, 418. GC, 8 November 2011, 2011-304, *JOR* 2012/14; Rb Amsterdam 12 November 2003, (Jungblut/Dexia Bank Nederland NV e.a.), *JOR* 2004/14, with ann. by S.E. EISMA; In the same sense regarding trading in options: Rb Amsterdam 2 March 2011, LJN BP7515, (Vestering Beheer BV e.a./ABN Amro NV), *JOR* 2011/147; Rb Utrecht, 31 May 2000, AG3651, (van Well/ Coöperatieve Rabobank Kromme Rijn BA), *JOR* 2000/156.

[1032] See for instance: CASPER and ALTGEN, 'Germany', para. 4.134, noting that "[…] the client is not obliged to investigate the risks of an investment even when the necessary information is publicly available". See on this topic also: GEIBEL, *Der Kapitalanlegerschaden*, 447 ff.; BENICKE, *Wertpapiervermögensverwaltung*, 877; VELDHOFF, *Die Haftung von Kreditinstituten*, 136.

[1033] ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, 142, para. 119; VELDHOFF, *Die Haftung von Kreditinstituten*, 136. BGH 13 January 2004, XI ZR 355/02, *BB* 2004, 515; *WM* 2004, 422; OLG Stuttgart , 27 October 2010, 9 U 148/08, *BB* 2011, 139; *WM* 2010, 2169; BGH, 19 December 2006, XI ZR 56/05, *BB* 2007, heft 17, 904 ff. ARENDTS also notes that the German courts traditionally set rather high standards to accept contributory negligence (M. ARENDTS, *Die Haftung für fehlerhafte Anlageberatung*, München, Beck, 1998 70-71); see also: SCHÄFER and MÜLLER, *Fehlerhafte Wertpapierdienstleistungen*, 23 para. 53 ff. See for an example: OLG Braunschweig, 12 June 1996, *WM* 1996, heft 33, 1484. Whereas the court in first instance (by the "*Landesgerichts*") considered the investor-claiamnt responsible for 50 percent of the loss because of negligence, the appellate court rejects this point of view holding that the investor resorts to a professional especially because of his own lack of awareness and sophistication. More recent reported case law nevertheless shows that to the extent that (the representative of) the (professional) investor fails to examine the conditions and features (such as the theoretical unlimited risk related to the highly speculative type of investment instrument) of the erroneously suggested investment, the investor bears responsibility as well; see: OLG Koblenz, 14 January 2010, 6 U 170/90, *WM* 2010, heft 10, 453-461 (the court held the investor responsible for 50 percent of the loss). To the extent an investor-claimant fails to clarify her aims or wishes when it would have been prudent to do so, she may be considered partly responsible for the loss. See for instance: OLG Nürnberg, 30 October 2009, 14 U 259/09, *WM* 2010, heft 9, 405-409 (50 percent contributory negligence established). See in this regard also: BAMBERGER, 'Anlageberatung', §50, 1465 para. 178; GEIBEL, *Der Kapitalanlegerschaden*, 450; SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1747.

[1034] Germany: ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, 142, para. 120. UK: Bank Leumi (UK) plc v Wachner (2011) EWHC 656 (Comm) Queen's Bench Division (Commercial Court) (delivered 22 March 2011) para. 324.

[1035] Germany: BENICKE, *Wertpapiervermögensverwaltung*, 877; S.J. GEIBEL, *Der Kapitalanlegerschaden*, Tübingen, Mohr Siebeck, 2002, 455; The Netherlands: VAN LUYN and DU PERRON, *'Zorgplicht'*, 280; UK.: J. FISHER and J. BEWSEY, *The law of investor protection*, London, Sweet & Maxwell, 2003, 566, para. 32-014; MCMEEL and VIRGO, *Financial advice*, 449, para. 18.01.

[1036] JP Morgan Bank (formerly Chase Manhattan Bank) v Springwell Navigation Corp (2008) EWHC 1186 (Comm), holding that "the matters amounting to contributory negligence would include the following factors, identified by Chase in its closing submissions, which show (often on the basis of Springwell's own case) a clear disregard for Springwell's own interests in the pursuit of profit: i) expecting a full advisory service throughout but never bothering:

a) to request such an advisory service or to agree or confirm the terms of the supposed advisory service;

292. Factors weighted in the assessment of contributory negligence. – Whether and to what extent the loss can be attributed to an investor-claimant is entirely dependent on the facts and the circumstances of the individual case. However, upon examination of the relevant case law, it seems that investor sophistication, measured in terms of his financial position, expertise and experience, risk appetite, of considerable importance, similar to what was the case with regard to the assessment of reliance.[1037] It should also be noted in this regard that in the Netherlands, courts can also adjust the degree of contributory negligence based on considerations of equity and fairness.[1038] The frequent application of the principles of contributory negligence in the context of investor losses in the Netherlands has also caused the Dutch Supreme Court to develop certain rules of thumb with regard to the assessment of the degree of contributory negligence. In cases of financial advice for instance, a standard has been developed to hold the investor responsible for about 50 percent of the loss.[1039] This follows from the consideration that the investor remains responsible for investment decisions taken within an advisory relation and should bear responsibility as well.[1040] Another generally applied rule stated by the Dutch Supreme Court holds that the negligence or lack of insight (*"lichtvaardigheid*" and *"gebrek aan inzicht*") on the side of the claimant-investor should count for less than the misconduct on the side of the financial institution-defendant in apportioning the damages.[1041]

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b) to explain to [X] or to anyone else at Chase, in clear terms, Springwell's investment objectives;

c) to consider, or raise with [X] or with anyone else at Chase, even the possibility that the investments being purchased were not consistent with Springwell's actual investment objectives;

d) to question whether [X], as an emerging markets specialist, could provide such an advisory service".

[1037] The Netherlands: Rb Amsterdam, 28 April 1999, LJN AG3594, (Veltman/MeesPierson NV), with ann. by C.M. GRUNDMANN-VAN DE KROL, r.o. 6.2, 11.2; Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216. See also: F.M.A. 'T HART, 'De maat van eigen schuld', *Ondernemingsrecht*, 2005, nr. 4125-133; see also for example: Rb Amsterdam 27 August 2003, LJN AI6105, (X./ Noordnederlands Effectenkantoor BV (NNEK)), *JOR* 2003/238, with ann. by K. FRIELINK; also available at www.rechtspraak.nl. Germany: BAMBERGER, 'Anlageberatung', 1465, para 178.

[1038] In a case where an apportionment of 50/50 was initially found correct, the court lowered the portion attributed to the client-investor to 25 percent based on the lack of experience and the severity of the breach on the side of the bank (allowing a badly informed, inexperienced investor to invest with borrowed money), see in this eegard: Rb Amsterdam 12 November 2003, *JOR* 2004/14, (Jungblut/Dexia Bank Nederland NV e.a.), with ann. by S.E. EISMA; HR, 3 February 2012, *JOR* 2012/116, (*Coöperatieve Rabobank Vaart En Vecht U.A./X.*), with ann. by S.B. VAN BAALEN; *Ondernemingsrecht*, 2012, afl. 8, 340-343, with ann. by A.A ETTEMA; Rb Amsterdam 1 June 2011, *JOR* 2011/230, (X./ABN Amro Bank NV); Hof 's-Hertogenbosch, 10 January 2012, LJN BV0971, (X./ABN Amro Bank NV), available at www.rechtspraak.nl; Rb Amsterdam 26 September 2007, case number 319951/HA ZA 05-1955, (x./Degroof & Cie Vermogensbeheer B.V.), available at www.rechtspraak.nl; Rb Amsterdam 7 March 2012, *JOR* 2012/216.

[1039] See for instance: Rb Amsterdam 2 March 2011, LJN BP7515, (Vestering Beheer BV e.a./ABN Amro NV), *JOR* 2011/147; Rb Amsterdam 28 January 2009, LJN BH5765, (x./ ABN Amro NV), available at www.rechtspraakzoeken.nl; Rb Dordrecht, 31 January 2007, LJN AZ8212, (X./ ABN Amro Bank N.V.), available at www.rechtspraakzoeken.nl; Hof 's-Hertogenbosch, 14 September 2010, LJN BQ1192, (Grove/ van Landschot Bankiers NV), *JOR* 2011/116. Hof 's-Hertogenbosch, 16 December 2008, *JOR* 2009/164. There are however countless cases where other percentages were used based on sophistication, who took the initiative for the disputed transactions, the degree of severity of the wrongful behavior and so on. For some examples: Rb Amsterdam 28 April 1999, LJN AG3594, (Veltman/MeesPierson BV), *JOR* 1999/149, with ann. by C.M. GRUNDMANN-VAN DE KROL (75 PERCENT contributory negligence while only 25 percent of the damages was imputed to the bank-defendant); Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216 (80 percent attributed to the bank, 20 percent to the investor-claimant for the latter remains partly responsible for the decisions made, though the limited sophistication and the fact that the client had inquired and objected at some point while the bank did not make any adjustments were counted in favor of the investor).

[1040] Idem. See also: Rb 's-Hertogenbosch, 21 December 2011, LJN BU8810, (X./F. Van Lanschot Bankiers NV), available at www.rechtspraak.nl, r.o. 4.23, though setting the percentage to be borne by the claimant at 40 percent in this case.

[1041] HR, 11 July 2003, *JOR* 2003/199, (van Zuylen te Landert/Coöperatieve Schaijk-Reek BA), with ann. by K FRIELINK*;* HR 17 December 2010, *RvdW* 2011, 14, (Noordnederlands Effektenkantoor B.V./X.), in particular r.o. 4.18; HR 23 May 1997, *NJ* 1998, 192, (Rabo/Everaers) with ann. by C.J. VAN ZEBEN, r.o. 3.3; HR 30 May 2008, *RvdW* 2008, 565, (De Boer c.s./TMF), r.o. 4.6; HR 5 June 2009 (X./Dexia Bank), in particular r.o. 4.16.1-4.16.2 and 5.6.1-5.7; Hof 's-Hertogenbosch 10 January 2012, LJN BV0971, (X./ABN Amro Bank NV), available at www.rechtspraak.nl; Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216; Rb Amsterdam 27 August 2003, *JOR* 2003/238, (X./ Noordnederlands Effectenkantoor BV

In some jurisdictions, it has also been noted that contributory negligence is more easily and more frequently applied in the context of financial advice and order execution services, mostly because investors retain at least partial responsibility for the investment decisions taken this context, as opposed to (discretionary) asset management for example.[1042] Courts in various jurisdictions have also developed the principle that to the extent that the defendant deliberately breaches his obligations, no contributory negligence defense can be invoked.[1043]

B. Mitigation of loss

1. Overview

293. The obligation to mitigate the loss is a defense available to the defendant and comprises a duty for the victim to undertake all reasonable steps to prevent the loss caused as a result of the wrongdoer's breach from accruing.[1044] The victim is entitled to compensation for the costs of the measures necessary to limit the expansion of the loss, regardless of whether the attempt proves successful.[1045] If a victim fails to undertake reasonable measures aimed at the mitigation, the defendant may demand an apportionment of the loss, often shifting the accrual of the loss that could have been avoided had the victim undertaken the necessary actions, to the latter. The obligation to mitigate the loss is generally acknowledged and applied in the Member States[1046] with the notable exception of France.[1047] The French Supreme Court has more than once denied that victims have a duty to mitigate

(NNEK)), with ann. by K. FRIELINK; also available at www.rechtspraak.nl; Rb 's-Hertogenbosch 21 December 2011, LJN BU8810, (X./F. Van Lanschot Bankiers NV), available at www.rechtspraak.nl., r.o. 4.24.

1042 For instance: the Netherlands: Rb Amsterdam 24 January 2007, *JOR* 2007/94, with ann. by F.M.A. 'T HART, r.o. 5.12; also available at www.rechtspraak.nl; Rb Amsterdam 11 March 2009, *RF* 2009, 76, (X./Drie Koningen Effecten B.V.). See also: VAN LUYN and DU PERRON, *'Zorgplicht'*, 280; VAN BAALEN, *Zorgplichten*, 418, stating that the investor-claimant is generally held responsible to a lesser extent for failing to notice and react to the breach of the financial service provider in cases of asset management. VAN LUYN and DU PERRON also note that courts appear rather restrained to easily accept contributory negligence on the side of the investor-claimant when it concerns pension funds (VAN LUYN and DU PERRON, *'Zorgplicht'*, 258); BUSCH and SILVERENTAND, 'The Netherlands', para. 7.167. See on the limited possibilities to invoke the defense of contributory negligence in the context of asset management in the UK also: VAN SETTEN, 'England and Wales', 364, para. 11.108. With regard to Germany: BALZER, 'Vermögensverwaltung', §51,1497, para 55.

1043 Germany: GEIBEL, *Der Kapitalanlegerschaden*, 459 and references cited in ftn. 65; Belgium: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 213, ftn. 1232 with reference to relevant case law. Switzerland: THÉVENOZ and BRETTON-CHEVALLIER, 'Switzerland', 324, para. 10.88 with reference to BGE, 30 November 2006, 4C.295/2006, available at http://www.bger.ch.

1044 UK: MCGREGOR, *McGregor on damages*, 7-001 ff.; BURROWS, *Remedies*, 128; VAN SETTEN, 'England and Wales', para. 11.107. Belgium: Cass. 14 May 1992, *J.L.M.B.* 1994, 48, with ann. by D. PHILIPPE; *R.W.*, 1993-94, with ann. by A. VAN OEVELEN; BOCKEN and BOONE, *Schadevergoedingsrecht*, 220 ff.; B. WEYTS, *De fout van het slachtoffer in het buitencontractueel aansprakelijkheidsrecht*, Antwerpen, Intersentia, 2003. The Netherlands: VAN BAALEN, *Zorgplichten*, 418; VAN LUYN and DU PERRON, *'Zorgplicht'*, 280; BUSCH and SILVERENTAND, 'The Netherlands', para. 7.168. See also: Rb Leeuwarden, 17 September 2008, LJN BF6426, (Lawant te Paterswolde/ Achmea Pensioen- en Levensverzekeringen N.V.), available at www.rechtspraak.nl, r.o. 2.7. Germany: Note that the German concept of the obligation to mitigate the damages is enclosed within the concept of contributory negligence laid down in §254 II BGB and as such, a specific application of contributory negligence. See for instance PALANDT (ed.), *Bürgerliches Gesetzbuch*, §254, para. 36. See also: BENICKE, *Wertpapiervermögensverwaltung*, 888-889; CASPER and ALTGEN, 'Germany', para. 4.136.

1045 Idem.

1046 See the references cited in ftn. 1044.

1047 For instance: Cass. 3e civ., 5 févr. 2013, Jurisdata 2013-001863; Cass., 2nd Ch. Civ., 19 June 2003, Jurisdata 2003-019462, (Dibaboui/Flamand e.a .) *Bull. civ.* 2003, II, n° 203; *JCP-G* 2004, I, 101, n° 9, with ann. by G. VINEY ("Attendu que l'auteur d'un accident est tenu d'en réparer toutes les conséquences dommageables; que la victime n'est pas tenue de limiter son préjudice dans l'intérêt du responsable"). See also: S. LE PAUTREMAT, 'Mitigation of damage: A French Perspective', 55 *I.C.L.Q.*, 2006, 209; COURET, GOUTAY and ZABALA, 'France', para. 3.127. See also. SPITZ, *La réparation*, 247, para. 403 and references cited in ftn. 115; H. ADIDA-CANAC, '"Mitigation of damage": une porte entrouverte?', *Rec. Dalloz*, 2012, 141.

the loss that emerged as a result of another party's fault. [1048] It was particularly held that the doctrine of the mitigation of loss conflicts with the principle of full compensation.[1049] Moreover, the court held that as a matter of principle, the victim is allowed to remain passive to the emergence of loss due to another party's breach.[1050] Despite this explicit and dogmatic rejection of the obligation to mitigate losses, French courts have yet occasionally reached outcomes very similar to what would have been decided in the context of the obligation to mitigate losses. The analysis in these decisions was carried out through the concepts of recoverable loss, causation[1051] or the concept of good faith.[1052]

294. Although the obligation to mitigate the damage may appear closely intertwined with the concept of contributory negligence at first glance, there is an essential difference. Whereas contributory negligence is considered an additional cause to the emergence of the loss, the obligation to mitigate the loss only becomes existent after the loss has been caused by the harmful action of another party. For instance, whereas the ambiguity on the investment objectives in *JP Morgan Bank (formerly Chase Manhattan Bank) v Springwell Navigation Corp*. and the recklessness to invest with borrowed money in the securities leasing cases contributed to the existence of the loss, the obligation to mitigate the loss focuses on the actions an investor should undertake once the loss has emerged.[1053] In this particular, case the investor should have contacted the asset manager to clarify the matter after having realized that the composition of the portfolio was out of line with the contractually agreed investment objectives.

[1048] Idem.

[1049] Idem.

[1050] Idem.

[1051] See for instance: Cass., comm., 10 January 2012, n° 10-26837, with ann. by P.-Y. BÉRARD and J.-L. GUILLOT, 'La responsabilité du banquier dépositaire de titres quant à la réparation de la perte d'une chance', *Revue Banque* 2012, n° 750. see also: CA Toulouse, 20 March 2012, Jurisdata 2012-005539, (Pressenda/Soc. Banque Populaire Occitane); in this decision the court held that the bank indeed failed to provide the client-investor with the required statements and periodic reports regarding the evolution of his portfolio. However, since the client-investor neglected to inquire about the investment for a period of five years, the court concluded that it was unlikely that the client-investor would have reacted to reports had they been sent by the bank-defendant. Hence, consequent to the displayed passivity on the side of the client-investor, the court considered the required causal connection between the breach and the loss was considered to be lacking. In a jurisdiction acknowledging the theory of the mitigation of damages, a highly similar result would most likely have been reached though rather based on the reasoning that the investor-claimant had (partly) forfeited his right to damages as a result of his passivity. See also: CA Paris, 15th Ch., 12 February 2009, Jurisdata 2009-002771, (S.A. CM-CIC securities/Rebbouh), in which it was held that the failure to object earlier against the transactions at matter exonerated the defendant for 10 percent of the loss.

[1052] In a contribution dating back to 1984, MICHAUD particularly held that that mitigation does not possess the same distinctive role and character in French contract law, where, on the contrary, it is completely intertwined with the legal concepts of direct loss ('*dommage direct'*) and recoverable loss ('*préjudice réparable'*); see A. MICHAUD, 'Mitigation of damage in the context of remedies for breach of contract', 15 *Revue Générale de Droit*, 1984, 309. For a similar remark in a more recent publication, see: LE PAUTREMAT, 'Mitigation of damage: A French Perspective', 206, with reference in ftn. 4. See also: M. JÓZON, 'Non-contractual Liability arising out of damage caused to another', L. ANTONIOLLI and F. FIORENTINI, *A factual assessment of the Draft Common Frame of Reference*, Munich, European Law Publishers, 2011 236. For an example, consult: CA Paris, 22 June 2001, *Rec. Dalloz*, 2002, 843, with ann. by COULON or the reference made to this case in LE PAUTREMAT, 'Mitigation of damage: A French Perspective', 207. In this case, the plaintiff claimed an unpaid debt though refused to exercise an option provided for in the contract to terminate the contract, causing the debt to accrue while knowing that the defendant was already struggling to pay off debts. The court decided that the part of the loss stemming from the continued duration of the contract was the result of bad faith on the side of the plaintiff for which the latter could not claim compensation. An identical result would have been achieved in applying the obligation of the mitigation of a loss. LE PAUTREMAT however points out that even though the result might have been the same, the application of the mitigation of damages as it exists in the UK is far more refined and contemplated.

[1053] See also LG Nürnberg-Fürth, 14 November 2002, *WM* 2003, Heft 18, 877.

2. Application of the mitigation of a loss in the context of investor losses

295. The duty to mitigate and preclude a further accrual of loss requires the victim to remain alert and intervene when reasonably possible and necessary, yet it also aims to prevent opportunistic behavior on the side of the investor.[1054] More particularly, by requiring investors to react upon finding that loss has emerged as a result of financial services provider's breach, courts discourage investors to postpone a response to await improvements that may or may not occur, knowing that potential losses can be claimed from the defaulting party anyway. Numerous applications based on this line of thought can be retrieved in the case law and have been discussed already in the context of the determination of the reference date.[1055] As will become clear throughout this section, the principle underlying the duty to mitigate the loss is the same as the one underlying the determination of the reference date, being the alignment of risk and responsibility. It is repeated that when investors become aware of a breach and the risk it brings along, but nonetheless keep investments without contacting the financial service provider or make corrective trades to rectify the situation when they are able to, they may be held liable for the consequences of those decisions and (lack of) actions too.[1056] As a result, the implications and rationale of the duty to mitigate the loss and the fixation of the reference date are highly similar. This section discusses the moment when the duty to mitigate the loss arises and the implications of the duty to mitigate the loss in terms of its impact on the compensation of investors loss.

a. The duty to mitigate the loss: discovery of breach

296. General overview: account statements and reports. – In order to be able to mitigate the loss flowing from the investment firm's breach an investor must become aware of the fact that a breach has taken place in the first place. In general, breaches are most frequently detected by means of the (mandatory) reports the investors receive from investment service providers. More particularly, according to art. 19 (8) MiFID investment firms are required to provide their clients with adequate reports on the service provided to their clients. These reports must, amongst other things, include information on the costs associated with the transactions and services undertaken on behalf of the client. Specific rules governing the duty to report to the clients have been set out depending on which investment services are being provided.[1057] Whereas asset management activities require periodic updates and account statements to inform the client on the performance and evolution of the portfolio, order execution generally requires a report confirming the execution of the client's order(s) and the details of the transaction. These reports allow investors to periodically monitor investment activities

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[1054] The Netherlands: HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 125; VAN BAALEN, *Zorgplichten*, 418; VAN LUYN and DU PERRON, *'Zorgplicht'*, 280; see also: Rb Leeuwarden 17 September 2008, LJN BF6426, (Lawant te Paterswolde/ Achmea Pensioen- en Levensverzekeringen N.V.), available at www.rechtspraak.nl, r.o. 2.7. Germany: BENICKE, *Wertpapiervermögensverwaltung*, 888-889.

[1055] See *supra*: para. 251 ff.

[1056] Idem.

[1057] Belgium: art. 27, §8, Law of 2 August 2002, on the supervision of the financial sector and on financial services; art. 21, art. 22 and 76, §2, Royal Decree of 3 June 2007 implementing the European Directive concerning markets for financial instruments, *B.S.* 18 June 2003; see extensively on the duty ro report in the context of asset management: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, chapter 6, 283 ff.; the Netherlands: C.M. GRUNDMANN-VAN DE KROL, *Koersen door de Wet op het financieel toezicht*, Den Haag, Boom Juridische uitgevers, 2010, 540, 544 ff., 570; VAN BAALEN, *Zorgplichten*, 337-345; D. BUSCH and C.M. GRUNDMANN-VAN DE KROL, *Handboek beleggingsondernemingen*, Deventer, Kluwer, 2009, 644. Germany: §31 (8) WpHG and §9 Verordnung zur Konkretisierung der Verhaltensregeln und Organisationsanforderungen für Wertpapierdienstleistungsunternehmen ("WpDVerOV "); see also: KÜMPEL (ed.), *Bank- und Kapitalmarktrecht*, 175 ff.; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, 177, para. 54; UK: Principle 7, FSA Principles of Business and COBS 16.2 and 16.3; see also in the context of asset management: SPANGLER (ed.), *Investment Management*, 156 ff; VAN SETTEN, *'The law of institutional investment management'*, 53, para. 2.55.

and keep an eye on the overall evolution of investments and may draw attention when striking, unexpected or alarming evolutions occur.[1058] Yet, the fact that information must be provided to the client also raises the question whether and to what extent these reports oblige clients to read them, monitor investments and transactions made on his behalf by asset managers, and react to this information. Different approaches exist depending on the type of service provided.

297. The duty to monitor and protest? – Most jurisdictions answer the question whether clients are expected to read interim reports and react to the information they contain affirmatively. When investors note – or should have noted – that something might be wrong, they are generally required to make inquiries and/or protest. This principle not only applies in the context of investor services, but is more generally applied as it is aimed at preventing loss from accruing and claims to filed long after the facts, causing the parties (and particularly the defendant) trouble to contest the claim.[1059] For instance, according to Dutch law, a general obligation applies to all creditors to complain upon the detection of an (alleged) contractual infringement or a breach of the duty of care under art. 6:89 DCC. The obligation to protest or complain under art. 6:89 DCC applies broadly, including the area of investment services, and requires an investor to react within a reasonable time ("*bekwame tijd*").[1060] The duration of this reasonable time depends on the factual circumstances of the case (and the kind of service provided, see below), going from a few days to a few weeks or even months, yet case law shows that multiple years are not considered timely.[1061] Depending on the complexity of the matter, longer periods may be tolerated.[1062] The lack of protest after the breach became apparent from the

[1058] DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 284, para. 291. See also with regard to the Netherlands: VAN BAALEN, *Zorgplichten*, 345. Rb Leeuwarden, 17 September 2008, LJN BF6426, (Lawant te Paterswolde/ Achmea Pensioen- en Levensverzekeringen N.V.), available at www.rechtspraak.nl, r.o. 2.7.

[1059] Rb 's-Hertogenbosch 19 July 2006, (Kortenhorst/van Lanschot Bankiers NV), *JOR* 2006/239, with ann. by F.M.A. 't Hart; confirmed in appeal: Hof 's-Hertogenbosch 5 August 2008, (Kortenhorst/van Lanschot Bankiers NV), *JOR* 2008/276 (partly rejected in HR 11 June 2010, LJN BL8297, (Kortenhorst/van Lanschot Bankiers NV), *JOR* 2010/199, with ann. by C.W.M. LIEVERSE); Rb Roermond, 24 February 2010, case number HA ZA 09-574, (Kortenoeven/ANB Amro Bank NV), *JOR* 2010/105; Rb Amsterdam, 1 October 2008, LJN BH3543, (A/ABN Amro Bank) available at www.rechtspraak.nl.

[1060] In 2013, the Dutch Supreme Court confirmed that the duty to protest in reasonable time also applies in the context of investment advice: HR 8 February 2013, LJN BY4600, available at www.rechtspraak.nl. Other relevant decisions in this regard: Rb Roermond 24 February 2010, case number HA ZA 09-574, (Kortenoeven/ANB Amro Bank NV), *JOR* 2010/105; Rb Amsterdam 1 October 2008, LJN BH3543, available at www.rechtspraak.nl;Hof 's-Hertogenbosch, 10 May 2011, LJN BQ4155, available at www.rechtspraak.nl; Rb Amsterdam 25 January 2012, BW1124, available at www.rechtspraak.nl; Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216; HR 11 June 2010, LJN BL8297, (Kortenhorst/van Lanschot Bankiers NV), *JOR* 2010/199, with ann. by C.W.M. LIEVERSE; BUSCH and SILVERENTAND, 'The Netherlands', para 7.118; Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216.

[1061] In general: In a case involving an investor-client who had a bank account with the bank-defendant, the court found that a failure to inform the bank of the fact that skimming by a third party had occurred for more than four months could not be considered within a reasonable time in the sense of art. 6:89 DCC. Instead, the court holds that in this case, the skimming could have been detected after only a few days when the first bank statements showed transactions not initiated by the client. The claim was rejected. Rb Alkmaar. 28 October 2009, LJN BK8469, (Baaijens/ Coöperatieve Rabobank Alkmaar), *JOR* 2010/98; in a decision delivered by the Utrecht Court of First Instance a period of several months was also found to have exceeded the reasonable time of art. 6:89 DCC (Rb Utrecht, 12 May 2010, case number 278760/HA ZA 09-2796, available at www.rechtspraak.nl); specificly in the context of investment services: the failure to complain for five years following the detection of a breach in the context of financial advice was considered excessive in Rb Roermond, 24 February 2010, case number HA ZA 09-574, (Kortenoeven/ANB Amro Bank NV), *JOR* 2010/105; similar: an investor who allegedly discovers a breach in 2002, but then waits to protest of formulate a claim for four years has failed to comply with his duty under art. 6:89 DCC and cannot claim compensation anymore, Rb Amsterdam, 1 October 2008, LJN BH3543, (A/ABN Amro Bank) available at www.rechtspraak.nl; see for similar cases: Rb Amsterdam 25 January 2012, BW1124, available at www.rechtspraak.nl (more than three and a half years had passed since the discovery of the breach before the investor protested, also in an advice relation); Hof 's-Hertogenbosch 21 December 2010, LJN BP4773, *JOR* 2011/145 (discovering the investment was unsuitable in 2002/2003, the investor does not respond to this finding until 2006/2007. The claim was rejected as a result); Hof 's-Hertogenbosch 10 May 2011, LJN BQ4155, available at www.rechtspraak.nl. HR,11 June 2010, LJN BL8297, (Kortenhorst/van Lanschot Bankiers NV), *JOR* 2010/199, with ann. by C.W.M. LIEVERSE.

[1062] Rb Amsterdam 13 November 2011, LJN BV1239, (X./F. Van Lanschot Bankiers NV), available at www.Rechtspraak.nl. in which a period of a year and a half was accepted in the light of the circumstances of the case.

information provided by the service provider may be considered to indicate the client-investor's tacit agreement with the course of events in certain circumstances.[1063] The latter has or may have repercussions for a future investor suit for damages filed by the investor-claimant. These consequences are discussed further below. The strictness with which the requirement to formulate a protest, and the time period within which the breach must have been noticed and a complaint must have been formulated also depends on the kind of investment service provided.

298. Order execution. **Duty to verify and protest.** – Especially in the context of order execution, a rather strict approach is taken towards the duty to protest. Investors are entitled to receive statements informing them on the execution of an order, including the specifics such as the price and time of execution. Insofar an irregularity has occurred in the execution of the order – for instance if the order has been executed incompletely or contrary to the conditions set by the client – an investor is required to react more or less immediately upon receiving the reports and detecting the problem.[1064] This is generally within a few days upon receiving the notice of the order execution.[1065] The exact period may be specified in the contract, though even if it has not been expressly stated in the contract, a limited period of time will apply.[1066]

299. Financial advice. Duty to verify and protest. – Whereas the duty to mitigate the loss requires a (more or less) immediate response in the context of order execution, clients are considered to have more time in the context of financial advice.[1067] This is the logical consequence of the fact that breaches may only become apparent over the course of time and the fact that investors – especially those who are inexperienced and unknowledgeable – may rely on the expertise and competence of

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[1063] Belgium: Antwerpen, 16 April 1994, *TBH* 1995, 1063, with ann. by J. BUYLE and X. THUNIS; Brussel, 23 January 2004, *TBH* 2006, afl. 1, 112, with ann. by J. BUYLE and M. DELIERNEUX; see for a critical assessment of the duty to protest and the assumed tacit agreement in absence of protest: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 299 ff.; S. DELAEY, 'Mondelinge beursorders - Het stilzitten van de cliënt na ontvangst van de rekeninguittreksels en/of bevestigingsborderellen bevraagd', *RW*, 2008-2009, nr. 7, 258. Luxembourg: MOREL and OMES, 'L'obligation d'information', 492. The Netherlands: VAN LUYN and DU PERRON, *'Zorgplicht'*, 146, 168 and references cited; France: Cass., comm., 27 November 2007, Jurisdata 2007-041664, (Bohnert Eckei/Caisse de Crédit Mutuel le Ried); CA, Paris, 15th Ch., 17 February 2005, Jurisdata 2005-282457, (Pernikoff/Le Crédit Industriel et Commercial de Paris), holding that the investor-claimant's tacit acceptance could be derived from the fact that he had not objected after receiving notes on the transactions (the contract states a period of two days upon notice to formulate a complaint); Interestingly, the court notes that the claimant cannot rely on the argument of not having a duty to monitor his investments since no asset management relation has been established. With regard to the duty to monitor the investments in the context of an asset management relation, see *infra*: para. 300 FF. *Contra*: CA Nancy, 2nd civ. Ch., 4 June 2009, Jurisdata 2009-012414, (S.A. Caisse d'Epargne et de Prévoyance de Lorraine Champagne-Ardenne/Mangel-Cronel), stating that the various statements and reports on the collective fund received by the investor-client do not have any contractual value, nor do they allow to derive the tacit acceptance of the instruments concerned by the client-investor; see also: CA Paris, 8th Ch., 9 January 2006, Jurisdata 2006-294036, (Leuillier/BNP Paribas Securities Services); Cass., comm., 13 June 1995, Jurisdata 1995-001512, (Société Didier Philippe/Epoux Nemegyei et autres), *Dall*. 1996, *J.* p. 71.

[1064] Belgium: Gent, 18 February 2004, *RABG* 2005, 297 with ann. by D. BLOMMAERT; Brussel, 23 January 2004, *TBH* 2006, 112, with ann.; Rb Antwerpen, 29 April 1992, *TBH* 1995, 1062, with ann. by J. BUYLE and X. THUNIS; Antwerpen, 11 April 1994, *TBH* 1995, 1063, with ann. by J. BUYLE and X. THUNIS; Kh. Brussel, 27 April 1992, *TBH* 1993, 1059, with ann. by J. BUYLE and X. THUNIS. See on this topic also: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 296;: DELAEY, 'Mondelinge beursorders', 258. Germany: KÜMPEL (ed.), *Bank- und Kapitalmarktrecht*, 2298, para. 17.147; The Netherlands: VAN BAALEN, *Zorgplichten*, 345.

[1065] Idem.

[1066] Belgium: Kh. Brussel, 10 October 1995, *TBH* 1996, 1101. Occasionally, courts have allowed longer periods, with or without a motivation to deviate. See for instance: the Netherlands: Rb Amsterdam 12 November 2003, (X./Dexia Bank Nederland), *JOR* 2004/13 with (critical) annotation by S.E. EISMA (illness of the claimant was excepted as a reason to allow for an extended complain period of three weeks in total); KCD, 12 July 2002, 2002-109, available at www.dsi.nl; France: Cour d'Appel Aix-en-Provence, 8th Ch., 17 November 1994, Jurisdata 1994-048753; CA Paris, 15th Ch., 17 February 2005, Jurisdata 2005-282457, (Pernikoff/Le Crédit Industriel et Commercial de Paris).

[1067] Hof 's-Hertogenbosch 21 December 2010, LJN BP4773, *JOR* 2011/145.

their advisor.[1068] For instance, the Dutch Supreme Court held that investors can only be expected to protest if they are aware of their duty to protest, and second, to the extent the investor has due reason to doubt that the defendant complied with its duty of care.[1069] This also implies that an investor must have been able to detect the breach, taken into account his sophistication, experience and understanding of information these reports and overviews contain.

Summarized, investors in an advisory relation are expected to monitor their investments and contact the financial advisor upon detecting a breach, yet the duty to protest is applied with more flexibility than is the case in the context of order execution and is to be assessed in the light of the circumstances of the case and the possibility for the investor to realized there has been a breach. Yet, if investors remain passive after the misconduct has been detected – or should have been detected – their impassivity or inertia may be held against them in the assessment of their claim for compensation.[1070]

300. The particular case of asset management – duty to monitor? – The question whether investors are required to monitor their investments needs an even more nuanced answer in case of asset management and is generally considered with varying degrees of flexibility in the courts. More particularly, since the asset manager has the (discretionary) power to manage the portfolio, the role of the investor is reduced to a minimum in this type of relations.[1071] A strict duty to monitor as applied in the context of order execution-relations would therefore run counter to the purpose of an asset management-relation, which is generally entered into precisely because an investor prefers to limit his involvement to a minimum by handing over the management of the portfolio to a professional.[1072] Hence, investor-claimants are generally considerably less likely to be found (partly) responsible for losses (or an accumulation thereof) in asset management relations.

[1068] Idem. see also: 'T HART, 'De maat van eigen schuld', 125-133; and Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216

[1069] HR, 8 February 2013, LJN BY4600, available at www.rechtspraak.nl.

[1070] On the implications of investor passivity, see below, para. 307.

[1071] Investors are generally not even considered authorized to interfere with the manager's policies and conduct in case of discretionary asset management relations. Belgium: Kh. Gent, 28 November 2000, *Bank. Fin. R.*, 2001, 191, with ann. by S. DEJONGHE; Kh. Brussel, 2 February 1995, *TBH* 1996, 1076; *contra:* Brussel, 19 February 2008, *TBH* 2010, afl. 2, 148, with ann. by R. HARDY; For an overview of the different views on the topic and a nuanced perspective: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 231 ff. France: Cass., comm.., 12 July 1971, n° 70-12039, *Rec. Dalloz*, 1972, *Jur.*, 153, with ann. by C. GAVALDA; see also COURET, GOUTAY and ZABALA, 'France', 87 para. 3.126 (noting that interference with the portfolio management may qualify as a cause of contributory negligence); *contra:* L. RUET in an annotation of Cass., 19 March 1996, *Bull. Joly Bourse*, 1996, 507; BONFILS notes that until the decision delivered by the French Supreme Court, the literature accepted that an asset manager has no obligation to execute the orders given by the client. Since the aforementioned judicial decision was delivered though, the literature appears more divided, see: BONFILS, *Le droit des obligations*, 229 and references cited; Luxembourg: BOURIN, *La gestion de portefeuille*, 228 and references cited. The Netherlands: VAN LUYN and DU PERRON, *'Zorgplicht'*, 237. See for instance: Rb Amsterdam 24 October 2012, *JOR* 2013/12, stating that in cases of asset management the responsibility for the investments is primarily borne by the asset manager. Given the nature of the relation, the court finds that investors may (at least initially) assume that the agreed guidelines and limits are respected by their asset managers, unless clear indications of the contrary have become apparent and obvious. In a similar sense: Rb Amsterdam 18 July 2012, *JOR* 2012/359, with ann. by J.W.P.M. VAN DER VELDEN.

[1072] See on this perspective also: Belgium: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 297. For an example, see for instance: KCD, 28 April 2003, 2003-74, available at www.dsi.nl. France: Cass. comm., 1 February 1994, Jurisdata 1994-000182, (STE Boescher/Brackers de Hugo); and CA, Paris, 15th Ch., 17 February 2005, Jurisdata 2005-282457, (Pernikoff/Le Crédit Industriel et Commercial de Paris), from which it can be understood that the passivity of the investor in the context of order execution is to be assessed more strictly than in case an asset management relation would have been established. Germany: SPROCKHOFF, 'Bankenhaftung Vermögensverwaltungsvertrags', 1747, holding that there is generally no duty to monitor or supervise the investment firm. Exceptions are only rarely made to this principle and only to the extent the investor is rather sophisticated according to SPROCKHOFF; see also SCHÄFER and MÜLLER, *Fehlerhafte Wertpapierdienstleistungen*, 150, para. 369; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 36-37. The Netherlands: Rb Amsterdam 18 July 2012, *JOR* 2012/359, with ann. by J.W.P.M. VAN DER VELDEN, particularly r.o. 4.12.

301. Restrictive approach in German courts. – Most notably in Germany, commentators have argued that the information the investor receives during the execution of an asset management relation offers the *possibility*, yet not the duty to monitor the performance and compliance of an asset manager with the contractual agreed terms and the general duty of care imposed on all service providers.[1073] Along these lines, it has been asserted that the failure to react upon receiving statements and/or reports sent to the investor with regard to the activities of the asset managers should not imply an approval or acknowledgment, nor should it affect the client-investor's right to compensation.[1074] This position is for instance repeatedly taken in the German case law, where investors are generally not expected to monitor the evolution and composition of the portfolio via periodic reports, nor the transactions executed on their behalf and notified to the client-investor on a continuous basis.[1075] Courts have adopted this point of view by reference to the investor's justifiable reliance that the contract is carried out according to the terms and conditions agreed on by both parties.[1076] As a result, the investor is generally not expected to monitor and supervise the asset manager, not even when the relevant information is available to him.[1077] Moreover, it has been withheld in the case law that the obligation to mitigate the loss does not apply during the period in which the contract is being executed.[1078]

[1073] France: CA Paris, 15th Ch., 17 February 2006, Jurisdata 2006-298471, (Loison/SA Banque Privée Européenne), holding that the mandate assigned to the asset manager releases the investor-client of the obligation to monitor the evolution of his portfolio ("[…] *que le mandate de gestion dispense le client de controller les opérations initiées par la banque, puisque le mandat est précisément destiné à libérer le client de tous les soucis liés à la gestion de son capital et ne l'oblige nullement à réagir aux avis qui lui sont envoyés* […]"); see also: CA Paris, 15th Ch., 20 October 2006, Jurisdata 2006-323933, (OI./Soc. Millenium Sar'Dail); CA, Paris, 15th Ch., 17 February 2005, Jurisdata 2005-282457, (Pernikoff/Le Crédit Industriel et Commercial de Paris), holding that the claimant cannot rely on the argument of not having a duty to monitor his investments since no asset management relation has been established; Belgium: Rb Brussel, 29 April 2005, *TBH* 2007, afl. 1, 69, with ann. by J. BUYLE and M. DELIERNEUX. This point of view is discussed and critically assessed in DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 298 ff. Germany: SCHÄFER, SETHE AND LANG (eds.), *Vermögensverwaltung*, §21, para. 36-37.

[1074] See for example: France: CA Aix-en-Provence, 12 January 2012, Jurisdata 2012-013958, (S.A.Financiere Fideuram/SARL Soc. Fin. D'Investissements et de Réalisations e.a.); see also Cass. comm., 1 February 1994, Jurisdata 1994-000182, (STE Boescher/Brackers de Hugo) in which the lack of reaction by the investor-claimants was not considered negligent or otherwise constitution wrongful behavior; CA Versailles, 15 December 2005, *Bull. Joly* 2006, 53, §5, with ann. by L. RUET; The Netherlands: KCD, 28 April 2003, 2003-74, available at www.dsi.nl; Rb Amsterdam 18 July 2012, *JOR* 2012/359, with ann. by J.W.P.M. VAN DER VELDEN. Switzerland: BGE, 3 December 2004, 4C.18/2004, cons. 1.8, see on this decision also: T. PACHMANN and H.C VON DER CRONE, 'Unabhängige Vermögensverwaltung: Aufklarüng, Sorgfalt und Schadenersatzberechnung', *SZW/RSDA*, 2005, nr. 3, 146; Pachmann en crone; BGE, 8 April 2005, 4C.342/2003, cons. 2.3.

[1075] BGH, 28 October 1997, XI ZR 260/96, *WM* 1998, heft 1, 21; OLG Frankfurt, 27 June 1995, *WM* 1996, heft 15, 665; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 37.

[1076] *"Bei solchen Geschäften mag eine Pflicht bestehen, die ordnungsgemäße Ausführung zeitnah zu kontrollieren. Mit einem entgeltlichen Vermögensverwaltungsvertrag, den der Kunde gerade abschließt, weil er die Verwaltung seines (Wertpapier-)Vermögens nicht selbst vornehmen, sondern sich davon und von der Überwachung der ordnungsgemäßen Ausführung von Aufträgen entlasten will, ist die Annahme einer solchen Pflicht unvereinbar. Der Kunde ist nicht gehalten, fortlaufend bei jeder Anlage alsbald nachzuprüfen, ob sie richtlinienkonform ist"*, BGH, 28 October 1997, XI ZR 260/96, *BB* 1998, heft 2, 71 (with reference to OLG Frankfurt *WM* 1996, 665, 668). See also: OLG Düsseldorf, 13 Juni 1990, 6 U 234/89, *WM* 1991, heft 3, 94-96, in which the court stated that the lack of protest or objections during the execution of the contract could not be considered as a tacit agreement with the defendant's harmful investment decisions. The client-investor entrusts the asset manager with the management of his investments and is not required to supervise or monitor the latter. The lack of protest was not considered harmful. The flexibility of the German courts towards investor passivity is also apparent in OLG Nürnberg, 30 October 2009, 14 U 259/09, *WM* 2010, heft 9, 405-409. In this decision the court decided the investor could not be reproached for not having sold the instruments upon realizing they were erroneously held in the portfolio, even though the instruments consequently lost two thirds of their value. The court accepted the investor's argument regarding the inability to foresee price evolutions and the decision to rather await potential improvements.

[1077] Idem, see also: ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §23, para. 55; CASPER and ALTGEN, 'Germany', 128, para. 4.134; BENICKE, *Wertpapiervermögensverwaltung*, 888-890; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 37.

[1078] OLG Frankfurt, 27 June 1995, *WM* 1996, heft 15, 669 (in particular under d)); SCHÄFER and MÜLLER, *Fehlerhafte Wertpapierdienstleistungen*, 150, para. 370; BALZER, 'Vermögensverwaltung', 1498, para. 56.

This is however not to say that an investor-claimant can infinitely and unconditionally remain passive according to German courts and literature. For instance, to the extent various statements received over a longer period of time bear clear evidence of violations, investors are required to react provided they are sufficiently apt to realize there has been a breach.[1079] Second, whereas notices relating to transactions executed by the asset manager during the contract and statements concerning the performance on a continuous basis (quarterly or half-yearly reports) generally do not comprise an obligation for the investor to monitor or supervise, the annual accountability reports ("*Rechenschaftsberichte*") stating the performance and evolution may constitute such an obligation.[1080] Hence, when various statements over a longer period of time clearly show a breach while the investor-client remains silent, a court may deduct the latter's tacit agreement with the policy and investments carried out.[1081] The latter is however rather exceptional since a high threshold applies to accept tacit agreement in this context.[1082] As a result of the high threshold to accept tacit agreement and the overall leniency applied by these courts towards investors, investors are not easily held accountable for passivity or inertia in practice, even if they noticed a breach for while and failed to react because they chose to await potential improvements. This is not problematic as long as this has been discussed and agreed by the asset manager who breached his duty of care. Yet in case the investors remain silent, hoping that the excessive risk that has been taken turns out in their advantage, they are offered a chance to behave opportunistic and speculate at the expense of the wrongdoer.

Thinking along those lines, BENICKE therefore argues in favor of a disconnection of the two concepts, suggesting that an alternative approach via contributory negligence might be better suited and more effective to preclude investor strategic behavior.[1083] Although not in favor of accepting a duty for the investor to monitor the asset manager, BENICKE argues that to the extent a breach becomes manifestly apparent from periodic reports, contributory negligence may be applied, provided that the investor-client has the necessary knowledge and sophistication to detect the problem and understand the implications.[1084] Lastly, once the contract has been terminated, the client-investor becomes responsible

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[1079] Idem.

[1080] ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §23, para. 55; BALZER, 'Vermögensverwaltung', §51, 1503, para. 66; However, noting the ambiguity and confusing on whether investors may be expected to notice the breach that continues to occur over a relatively long period of time in the case law: BENICKE, *Wertpapiervermögensverwaltung*, 879. Consult in this regard also: BGH, 28 October 1997, XI ZR 260/96, *BB* 1998, heft 2, 71. In this case, the investor-claimant was awarded damages even though he had failed to complain for over five years while the statements he received were showing the asset manager violating the investment guidelines (BGH, 28 October 1997, XI ZR 260/96, *BB* 1998, heft 2, 71). *Comp.:* CA Toulouse, 20 March 2012, Jurisdata 2012-005539, (Pressenda/Soc. Banque Populaire Occitane); in the latter case the investor did not even receive statements or reports for five years. The Toulouse appellate nevertheless rejected the claim considering that statements would not have made a difference since the claimant had not made a single inquiry or remark relating to the investment activities. It appears that passivity on the side of the investor is more tolerated in German courts, relatively compared to the French.

[1081] CASPER and ALTGEN, 'Germany', 128, para. 4.134; BENICKE, *Wertpapiervermögensverwaltung*, 879-880. Nuances are necessary however, given the state of the case law. See for instance BGH, 28 October 1997, XI ZR 260/96, *BB* 1998, heft 2, 71, discussed in the previous footnote.

[1082] In the context of asset management tacit agreement concerning a modification of investment objectives derived from mere silence is generally not accepted. Additional indications of such tacit agreement are principally required (BENICKE, *Wertpapiervermögensverwaltung*, 882-883). Similarly in Belgian law, tacit agreement is generally only accepted if circumstances or additional indications confirm the acceptance of a party ("*omstandig stilzwijgen*"). See also: Cass., 6 June 2011, (S.R./Fortis Banque), *Bank. Fin. R.*, 2011, afl. 4-5, 278; Commercial Court, Brussel, 12 July 2007, (J. Mounier/SA Fortis Banque), *TBH* 2009, afl. 1, 53, with ann. by B. CAULIER; B. SAMYN, 'De bewijslast. Rechtsleer getoetst aan tien jaar cassatierechtspraak – deel 2', *P&B/RDJP* 2010, 50.

[1083] BENICKE, *Wertpapiervermögensverwaltung*, 884. In a similar sense: DELAEY, 'Mondelinge beursorders', 268; DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 311.

[1084] BENICKE, *Wertpapiervermögensverwaltung*, 889-890. See also: CASPER and ALTGEN, 'Germany', 128, para. 4.134-136; BALZER, 'Vermögensverwaltung', §51, 1498 para. 55.

for the portfolio and may be held to mitigate the loss when wrongful investments have been made. The investor is granted time to consult with other professional financial service providers to gather information and advice, but is likely to be held responsible for the accrual of the loss incurred as the result of his passivity after the termination of the contract.[1085]

302. Comparative overview. – Although more leniency and flexibility is applied towards investors in an asset management relation in other jurisdictions too, the standards and expectations may be considered a relatively more demanding from the perspective of investors, compared to the German example in the previous paragraph.[1086] In the Netherlands and Belgium for instance, investors are generally expected to inform themselves of the general evolution and state of their portfolio.[1087] There is no obligation to closely monitor the evolution of the investments nor are investors required to immediately respond to each report they receive in this regard.[1088] Only to the extent an investors fails to react on reports showing breaches or other indications that should rouse suspicion, they are required to react and may be held responsible in case they fail to do so. In the Netherlands for instance, a distinction has been made between statements ("*dagafschriften*") informing the client of the particular transactions entered into by the asset manager, and those periodical reports ("*vermogensoverzicht*") offering overview of the performance, evolution and composition.[1089] The latter are expected to be read by the investor and may constitute a breach of the investor's duty to protest when the investor remains silent for a reasonable period after having received these reports while the reports clearly indicate a breach has occurred.

303. In France, case law shows a lenient approach towards asset management relations as well.[1090] As a matter of principle, the investor-claimant is not expected to react immediately to information received concerning his investments. An investor showing a clear lack of interest on the other hand, for instance failing to react to information clearly revealing a breach on the side of the asset manager, or remaining completely passive and silent for several consecutive years, is considered negligent.[1091] Overall, it can be concluded that investors are not required to closely monitor their portfolio and investments, nor that they must react immediately to reports, statements or other information

[1085] OLG Frankfurt, 27 June 1995, *WM* 1996, heft 15, 669. See also: SCHÄFER and MÜLLER, *Fehlerhafte Wertpapierdienstleistungen*, 150, para. 370 and 371.

[1086] Luxembourg: BOURIN, *La gestion de portefeuille*, 230-231 and case law cited; Switzerland: LOMBARDINI, *Droit bancaire suisse*, 357-358, 438, 440 and cases cited; Belgium: Brussel, 27 April 2012, *JLMB* 2012, no. 25, 1203; France: CA Toulouse, 20 March 2012, Jurisdata 2012-005539, (Pressenda/Soc. Banque Populaire Occitane); CA Paris, 15th Ch., 12 February 2009, Jurisdata 2009-002771, (S.A. CM-CIC securities/Rebbouh); Paris, (15th Ch.), 2 October 2001, Jurisdata 2001-160531 (Wargny/X.); CA Paris, (1st Ch.), 27 January 1998, *Bull. Joly Bourse* 1998, 245, §64, with ann. by J.-J. M. MOUSSIO. The Netherlands: VAN LUYN and DU PERRON, *'Zorgplicht'*, 260 ff.

[1087] The Netherlands: VAN BAALEN, *Zorgplichten*, 345; Belgium: Bergen, 7 October 2004, *Bank. Fin.* R. 2006/II, 94, with ann. by S. DELAEY; Rb. Verviers, 29 May 2006, *TBH* 2008, 96; DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 311; Rb Verviers, 29 May 2006, *TBH* 2008, afl. 1, 96; Brussel, 3 September 2008, *TBH* 2010, afl. 2, 169.

[1088] Belgium: Brussel, 27 April 2012, *JLMB* 2012, no. 25, 1203; Rb Brussel, 29 April 2005, *TBH* 2007, afl. 1, 69, with ann. by J. BUYLE and M. DELIERNEUX.

[1089] VAN BAALEN, *Zorgplichten*, 345. *Comp.* (Belgium) Rb Verviers, 29 May 2006, *TBH* 2008, afl. 1, 96.

[1090] CA Paris, 15th Ch., 17 February 2005, Jurisdata 2005-282457, (Pernikoff/Le Crédit Industriel et Commercial de Paris), implying that the passivity of the investor in the context of order execution is to be evaluated more rigorously compared to a similar situation in the context of asset management. See for an example: Cour d'appel Paris, 15th Ch., 10 June 2005, Jurisdata 2005-279464, (S.A. Aurel Leven Securities/De Botton), with ann. by H. DE VAUPLANE and J.-J. DAIGRE, *Banque & Droit,* 2006, n° 105, 41-42. Although the claimant had received various reports sent during consecutive years, showing that the strategy had been modified, the court did not consider the failure to protest negligent or an obstacle to the investor-claimant's claim for damages; CA Paris, (15th Ch.), 2 October 2001, Jurisdata 2001-160531 (Wargny/X.); CA Paris, (1st Ch.), 27 January 1998, *Bull. Joly Bourse* 1998, 245, §64, with ann. by J.-J. M. MOUSSIO.

[1091] CA Toulouse, 20 March 2012, Jurisdata 2012-005539, (Pressenda/Soc. Banque Populaire Occitane).

documents in the context of asset management. Only to the extent clear indications exists and should have been noticed by a prudent investor in similar circumstances, the investor may be held responsible for (part of) the loss suffered.

304. A considerably more rigorous approach towards an investor's duty to protest is applied in Switzerland. Moreover, banks have developed a practice of requiring the client to sign off the statements and derive the latter's tacit consent from those signatures with the transactions mentioned in the statements.[1092] THÉVENOZ and BRETTON-CHEVALIER note in this regard that this practice has been accepted and confirmed in the case law, yet generally without investigating whether the client-investor was actually sufficiently knowledgeable to correctly assess the information.[1093] Hence, the failure to react upon receiving reports and statements providing information on the activities, performance and evolution of the portfolio is considered a silent ratification of the activities, possibly bearing consequences for a future claim for damages.[1094] To the extent the investor's ability to grasp the implications of the information provided is not examined however, the (standard) practice of demanding signatures to avoid future complaints should be seriously questioned on its merits and consequences.[1095]

305. Conclusion. **Duty to protest in case of awareness of breach.** – Regardless of the exact conditions and standards set with regard to the obligation to monitor the investment evolution, it is accepted as a matter of principle that once an investor has discovered misconduct, he is required to react.[1096] In the hypothesis that the wrongful execution of an order has been or should been detected upon reading the statement or report received[1097], it is acknowledged that a failure to do so constitutes an act of negligence on the side of the investor, provided that the latter cannot offer a reasonable excuse or explanation for his failure to protest upon receiving the notice.[1098] The same goes for breaches in the context of asset management insofar the investor has or should have realized something was wrong. The latter is generally assessed in the light of the particular circumstances of the case, including the degree of investor sophistication.[1099] Not every faulty action is (clearly) visible

[1092] THÉVENOZ and BRETTON-CHEVALLIER, 'Switzerland', 324, para. 10.87; LOMBARDINI, *Droit bancaire suisse*, 822, para. 74.

[1093] Idem. LOMBARDINI notes in this regard that execution statements should contain the details of the orders executed, such as the counterparty (executed on the stock exchange or internally with the bank), the price, and so on. The reports informing the client on the portfolio performance and evolution should inform the client on the composition of the portfolio, the sectors in which has been invested, the duration of the investments, costs involved etc. See: LOMBARDINI, *Droit bancaire suisse*, 816.

[1094] The compensatory claim may be rejected as a result of the silent acceptance, see for instance: THÉVENOZ and BRETTON-CHEVALLIER, 'Switzerland', para. 10.87. The latter point of view has been rejected by the Swiss Supreme Court however: BGE, 3 December 2004, 4C.18/2004, cons. 1.8; BGE, 8 April 2005, 4C.342/2003, cons. 2.3, both decisions available at: www.bger.ch. The confusion on the consequences of assumed tacit agreement in this context is also noticeable in other jurisdictions.

[1095] *Ibid.*, para. 10.87.

[1096] The fact that losses are being recorded is not sufficient to assume a client is aware of any violation. Losses may be suffered exclusively due to market circumstances. The duty to protest only exists to the extent it was possible for the investor-claimant – taken his level of sophistication into account – to discern wrongful conduct. See for instance: (The Netherlands) Rb Amsterdam 26 September 2007, case number 319951/HA ZA 05-1955, (x./Degroof & Cie Vermogensbeheer B.V.), available at www.rechtspraak.nl; Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216; (Belgium) Kh. Brussel, 24 April 2013, *TBH* 2013, 174.

[1097] Breaches are not always apparent from the information sent to the client-investor though. See for instance: CA Paris, 15th Ch., 26 January 2006, Jurisdata 2006-194021, (Vidalies/Soc. Civ. Fin. Alexis Davivier), in which the court held that since the reports the client received were not sufficiently detailed and overall deficient to provide the client with an accurate overview of his investments, the absence of protest cannot be considered negligent.

[1098] On the sanctions of the failure to protest, see below.

[1099] With regard to the Netherlands, reference can made to 't Hart's contribution on the matter: 'T HART, 'De maat van eigen schuld', 125-133; see also Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216; Hof 's-Hertogenbosch 21 December 2010, LJN BP4773, *JOR* 2011/145.

from the periodical reports, causing the courts to take once again the sophistication of the investor into account in assessing when a reasonable investor in the same circumstances, with a similar degree of understanding and sophistication, should have noticed the problem.[1100]

306. Notwithstanding the common principle however, some differences in the application are discernible in the case law of the various Member States, in particular with regard to the duty to control asset management activities. Whereas Belgian and especially Dutch courts show less restraint to attach consequences to failures to protest after receiving information from which the breach should have been apparent, German courts have displayed more reluctance.[1101] Consequent to the detection of the breach, the investor may be expected to take action such as contacting the investment firm to discuss the problem, formulating a complaint, terminating the contract or even liquidating (part of) the portfolio. The next question that needs to be asked relates to the legal consequences of the failure to formulate a protest within a reasonable period of time in regard of an investor suit for damages following the wrongful behavior that became apparent from the statements received.[1102]

b. Consequences of the failure to protest in the light of investor suits

i) Overview

307. Examination of reported case law shows that courts attach a range of different consequences to the failure to timely protest. In some instances, investors have been denied a right to compensation as a result of their lack of protest, either based on the reasoning that their right to compensation had expired or that the debtor had been released of his duty to adequately execute the contract since the investor-client could be considered to have tacitly accepted the breach.[1103] In other cases, investors were considered partly responsible for the loss incurred as a result of their own negligence (contributory negligence)[1104] whereas in yet other cases and scholarly literature, investors have been

[1100] See for instance Rb Amsterdam 28 April 1999, LJN AG3594, (Veltman/MeesPierson NV), with ann. by C.M. GRUNDMANN-VAN DE KROL, r.o. 6.2, holding that the financial position and expertise of an investor-client are considered in assessing whether or not there is responsibility; see also Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216. See on decisive factors in assessing contributory negligence in a Dutch context also: *Ibid.*, 130 ff.

[1101] CASPER and ALTGEN, 'Germany', para. 4.134-136; BENICKE, *Wertpapiervermögensverwaltung*, 879-880; BALZER, 'Vermögensverwaltung', §51, 1498 para. 55;

[1102] See for this question answered in a mainly Belgian context of order exection: DELAEY, 'Mondelinge beursorders', 262; for an assessment of this question in the context of asset management: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 295 ff.

[1103] In Dutch: "*rechtsverwerking*" or "*rechtsverval*"; in French: "*déchéance*"; regardless of the exact terminology in each jurisdiction, the sanction for failing to timely protest in this constellation is the forfeiture of the investor's right to compensation. See extensively: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 298. For examples: see for isntance: Belgium: Kh. Brussel, 12 July 2007, *TBH* 2009, afl. 1, 53 with ann. by B. CAULIER. It should be noted that in the Netherlands, violations of the duty to protest as imposed on parties by art. 6:89 DCC are generally sanctioned by forfeiture of the claimant's right to compensation (Court of First Instance, 's-Hertogenbosch, 19 July 2006, (Kortenhorst/van Lanschot Bankiers NV), *JOR* 2006/239, with annotation on the topic by F.M.A. 't Hart). See for additional examples: Court of First Instance, Amsterdam, 25 January 2012, BW1124, available at www.rechtspraak.nl; Court of First Instance, Roermond, 24 February 2010, *JOR* 2010/105, (Kortenoeven/ANB Amro Bank NV); Rb Amsterdam, 1 October 2008, LJN BH3543, available at www.rechtspraak.nl; KCD, 2 February 2001, 2001-40, available at www.dsi.nl; KCHB, 24 February 2004, 2004-68, available at: http://www.dsi.nl. Besides the implications of protest in terms of acceptation of the policy and transactions conducted by the intermediary, the lack of protest upon receiving reports or statements is also used to prove the existence and correct execution of an oral order by the client-investor. See for instance: France: CA Paris, 22 May 2008, Jurisdata 2008-373024, (D./SA Global Equity); Belgium: DELAEY, 'Mondelinge beursorders', 258 ff.

[1104] See for instance BGH, 2 May 2002, II ZR 100/01, *WM* 2002, 1177, also available at www.juris.bundesgerichtshof.de. In this decision the investor-claimant's letter stating he was satisfied with the transactions executed by the asset manager was considered an approval of the policy conducted so far. Since the asset manager had exceeded the contractually agreed limit for derivatives trading already at that time and since the investor was aware of this, as is apparent from the previous considered responsible for loss that accrued as a result of their failure to mitigate the loss.[1105] Examples of cases in which investors were considered to have forfeited their right to compensation ("*rechtsverwerking*") can be found in Dutch, Belgian and French reported case law.[1106] In the scholarly literature, however, it has been asserted that the application of these civil law concepts attached to the assumption of tacit agreement is neither very straightforward nor convincing in the context of defective investment services.[1107] Overall, the case law is inconsistent and blurred when it comes to the legal consequences of a failure to protest. As a consistent and adequate approach to investor passivity or opportunistic behavior is hence lacking, a more flexible and accurate approach based on a consistent application of the obligation to mitigate the loss is discussed in the next paragraphs.[1108]

308. Mitigation of damages: aligning risk and responsibility revisited. – Prior to setting out the implications and application of the duty to mitigate the loss in the light of the different types of investor services and relations it should be stressed however that the duty to mitigate the loss does not imply that an investor is expected to know at what point a sale or portfolio liquidation is most favorable. Whether recovery or further deterioration is likely to occur is unpredictable and unforeseeable. Rather than a means to actually limit the scope of the loss, the real value of the application of the obligation to mitigate the damage lays with its use as a mechanism to prevent investor opportunism.[1109] Requiring an investor to act upon detecting misconduct aims at forestalling opportunities to speculate at the expense of the wrongdoer, regardless of whether the markets deteriorate, recover or soar in the (near) future. Or as VAN LUYN and DU PERRON put it, the duty to mitigate is mainly a means to reallocate the risk and prevent strategic behavior on the side of the investor.[1110] As a result, a prudent course of action should not be considered wrongful, regardless of future market evolutions. It cannot be expected from investors – not even professionals – to foresee

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communication between the parties, the BGH concludes that the investor-claimant had approved the breach. The BGH thereby rejected the appellate court's interpretation of the letter, holding that the investor's statement must be interpreted as a mere figure of speech without meaning to it. Although the BGH thus attaches more importance to the conduct of the investor-claimant, the impact of the approval is only awarded limited meaning. The BGH for instance holds this approval for the first six weeks of the contract period does not imply an agreement with the following and more farreaching violations of the contract, such as the lack of diversification and a long term strategy, nor does it imply the investor's agreement with a modification of his profile or strategy. The approval only covers the period prior to the writing and is without consequences for the continuing execution of the contract.

[1105] With regard to the Dutch case law: KCD, 16 January 2003, nr. 2003-05, available at http://www.dsi.nl; see also the references cited in VAN LUYN and DU PERRON, *'Zorgplicht'*, 171, ftn. 120-123. VAN LUYN and DU PERRON also note that it is hard, if not impossible, to predict which consequence may be attached to the failure to make objections in an individual case (p. 172). Similar: VAN BAALEN, *Zorgplichten*, 347. For a Belgian example: Kh. Brussel, 24 April 2013, *TBH* 2013, 174.

[1106] The Netherlands: Rb Roermond, 24 February 2010, case number HA ZA 09-574, (Kortenoeven/ANB Amro Bank NV), *JOR* 2010/105; Rb Amsterdam 25 January 2012, BW1124, available at www.rechtspraak.nl; Rb Alkmaar. 28 Oktober 2009, LJN BK8469, (Baaijens/ Coöperatieve Rabobank Alkmaar), *JOR* 2010/98; See also: VAN LUYN and DU PERRON, *'Zorgplicht'*, 171; VAN BAALEN, *Zorgplichten*, 347. See extensively on this topic with references to both the Belgian and French case law: (Belgium) DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 298-311. See in this context also: Kh. Brussel, 12 July 2007, *TBH* 2009, afl. 1, 53 with ann. by B. CAULIER. The court confirmed that the lack of protest on the side of the investor-claimants (in the context of asset management) did not imply a forfeiture of their right to file claim, though it did cause the impression and hence assumption to exist that they agreed with the manner the asset management was conducted. See also: Kh. Brussel, 24 April 2013, *TBH* 2013, 174. See also Germany: OLG Frankfurt, 27 June 1995, *WM* 1996, heft 15, 669.

[1107] More extensively: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 298; for a German perspective: BENICKE, *Wertpapiervermögensverwaltung*, 882, 885. France: CA Paris, (15th Ch.), 2 October 2001, Jurisdata 2001-160531 (Wargny/X.); CA Paris, (1st Ch.), 27 January 1998, *Bull. Joly Bourse* 1998, 245, §64, with ann. by J.-J. M. MOUSSIO.

[1108] Also: DELAEY, *De Contractuele verhouding inzake portefeuillebeheer*, 311; BENICKE, *Wertpapiervermögensverwaltung*, 882, 884.

[1109] VAN LUYN and DU PERRON, *'Zorgplicht'*, 282. Similar: VAN BAALEN, *Zorgplichten*, 346-347, 418; BENICKE, *Wertpapiervermögensverwaltung*, 888-889; similar: F.M.A. 't Hart in his annotation on Hof Amsterdam, 5 December 2002, (van Luyn/Dexia Bank Nederland NV), *JOR* 2003/116.

[1110] Idem.

market evolutions and be able to liquidate an investment at the most favorable point in time.[1111] Case law however shows confusion and contradiction on this point.[1112]

ii) Mitigation of damages in the context of deficient order execution

309. Mitigation of loss as risk (re)allocation instrument. – As discussed earlier already, in case an order is wrongly or incompletely executed, an investor is required to direct his complaint to the investment firm within a few days following the reception of the execution note and take action as soon as possible, generally the first trading day following discovery of the breach.[1113] For instance, in case securities he ordered to sell have not been sold, the investor may be required to sell on the first trading day following discovery of the breach to limit the loss that may result from the wrongdoer's breach. In case the investor decides not to sell at this point in time and await further price evolutions, he is free to do so, yet the risk on further deterioration is his to bear. Regardless of whether or not the investor decides to (re)order the sale, the loss incurred as a result of the failure of the first order, i.e. the negative price difference between the value of the securities at the moment when the order should have been executed and the value at the moment when the investor was able to (re)order the sell again, can be recovered from the wrongdoer.[1114] Illustrations of this approach are mostly found in the Dutch case law, where courts have developed the thumb rule that recoverable damages are fixed on the first trading day following the discovery of the fault (or the moment at which the fault should have been discovered).[1115] This interpretation of the duty to mitigate the loss entirely corresponds with the

[1111] BALZER, 'Vermögensverwaltung', §51, 1498; Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216. Similar, though drawing the conclusion that this implies that an investor-claimant cannot be expected to sell because of this unpredictability: DE VUYST, ''Beste uitvoering' (best execution) van beursorders: de zorgvuldigheidsnorm nader bekeken', (annotation of Brussel, 30 Juni 2003) para. 25-26. In another, more recent, Belgian decision though, the Brussels Court of appeal held the investor-client responsible for the loss suffered after liquidating his portfolio pursuant the discovery that the asset manager had been negligent and the value of the portfolio had suffered considerable losses. The appellate court held that the investor should be held responsible for selling the instruments in the midst of a crisis at very low prices, and more particular, that ht decision to sell had disrupted the required causal connection between the violation and the loss. The fact that the investor could not have known that the prices reached the lowest point at the moment of liquidation was not mentioned. The decision therefore seems to suffer from hindsight bias (Kh. Brussel, 2 March 2011, *TBH* 2012, afl. 4, 378). In the Netherlands on the other hand, FRIELINK has argued that the mere decision to keep securities of which the purchase was considered wrongful, is not causally related to the claimed loss, for such decision disrupts the causal connection. The latter point of view in other words completely contradicts the Brussels appellate decision (KCD, 27 August 2002, 2002-152, *JOR* 2003/90, with ann. by K. FRIELINK).

[1112] See for instance: Kh. Brussel, 2 March 2011, *TBH* 2012, afl. 4, 378 (holding the investor responsible for the loss incurred by liquidating the portfolio in a reaction to the violation on the side of the investment firm in the midst of a financial crisis); OLG Nürnberg, 30 October 2009, 14 U 259/09, *WM* 2010, heft 9, 405-409 (holding that the investor could not be reproached for his inertia in preserving the investment after discovering negligent behavior). *But*: Rb Amsterdam 7 March 2012, LJN BW4297, *JOR* 2012/216.

[1113] *Supra*, para. 252.

[1114] Idem.

[1115] The Netherlands: Hof 's-Hertogenbosch, 23 March 2004, LJN AO7085, (X./ING Bank NV), available at www.rechtspraak.nl, in particular r.o. 4.9; Rb Maastricht, 6 June 2002, LJN AE4277, (X./ING Bank NV), available at www.rechtspraak.nl, in particular r.o. 3.6; Rb Alkmaar, 11 March 2009, *JOR* 2009/136, (X./ING Bank NV); Rb Amsterdam, 13 April 2011, *JOR* 2011/224, (X./ABN Amro Bank NV); KCD, 27 February 2002, 2002-44, available at www.dsi.nl; KCD, 4 May 2001, 2001-119, available at www.dsi.nl (client-investor gave an order to sell without specifying whether it concerned a market or a limit order. Assuming the latter, the investment firm set a limit of €47 per share without verifying the details with the client-investor. Since the stock noted below €47 per share at that point in time the order was not executed. The client was informed of the failure to sell only after three days, though decided not to renew the order (shares listed at €43 at that time) but instead kept the securities at matter. The Complaints Board decides to award damages equal to the difference in value as measured on the day of the order and the day the client was informed. The investor bears responsibility for any later fluctuations pursuant his decision not to sell.); KCD, 1 February 2001, 2001-39, available at www.dsi.nl; KCD, 7 February 2001, 2001-48, available at www.dsi.nl. See also: M. VAN LUYN and E. DU PERRON, *Effecten van de zorgplicht*, Deventer, Kluwer, 2004, 283. See in this sense also Germany: LG Nürnberg-Fürth, 14 November 2002, *WM* 2003, heft 18, 877; Belgium: Kh. Brussel, 10 October 1995, *TBH* 1996, 1101. For a different approach: Brussel, 30 June 2003, *Bank Fin.R.*, suggested approach to the determination of the reference date set out in the beginning of this chapter. As several of these examples have been discussed in the section on the determination of the reference date already, these examples are not repeated at this point.[1116]

iii) The mitigation of damages in the context of asset management and financial advice

The context of asset management and financial advice differs from execution only-services in the sense that the responsibility for the investment decisions is a joint responsibility in case of financial advice borne by both the advisor and investor-client, or even more or less exclusively in case of asset management.[1117] As a result, as long as the contract is being executed, the investment firm is at least partly responsible for the decisions and measures taken as a result of its services. When noting that something is not in line with the contractually agreed terms or expectations, an investor usually contacts and consults with his advisor or asset manager.[1118] It may be that modifications to the investment profile are necessary, or that corrections should be carried out with regard to the portfolio composition. If investors detect a breach but nonetheless remain passive and silent, they may be held liable for the loss that accrued in the period after they became aware of the problem.[1119]

A decision handed down by the Brussels appellate court for defective asset management may clarify how the duty to mitigate losses in this context may work.[1120] In this case a claim was filed by investors against the bank-asset manager because the bank-asset manager had modified the investment strategy employed to manage the clients' portfolio without duly warning the investors on the risks that came with this modification. The clients had concluded an asset management contract with a bank in January 1997 in which it was stated that the 30 percent of the funds should be invested in shares, while the remaining 70 percent should be invested in bonds. Three years later, the clients consented to change to composition of the portfolio from 30 percent shares and 70 percent bonds to 100 percent investments in shares (March 2000). The asset manager did not inform or warned the clients on the increase in risks to which the portfolio would be exposed, however, until two years later (February 2002).[1121] The investor-clients were also recommended to adjust the investment strategy to a more conservative strategy at this point in time. Despite the warnings and recommendations to lower the risk exposure, however, the investor-clients did not immediately respond to the advice and held on to the strategy for another nine months (November 2002). In November 2002, the parties agree on an investment strategy of 50 percent investments in shares and 50 percent in bonds, a composition which may be adjusted in the light of the market evolutions, though without exceeding a maximum of 65 percent of the funds invested in shares. In May 2003, the investors file a complaint with bank's mediation service and send a copy to the financial sector's ombudsman. As the complaint is dismissed

2004, afl. 3, 175, with ann. by V. DE VUYST. With regard to France, consult: BONFILS, *Le droit des obligations*, 308, para. 626-628 and the references cited.

[1116] *Supra*, para. 252.

[1117] *Supra*, para. 260.

[1118] VAN LUYN and DU PERRON, *'Zorgplicht'*, 146, 285.

[1119] See *supra*, para. 307 ff.

[1120] Brussel, 27 April 2012, *JLMB* 2012, no. 25, 1203. See also: Rb Verviers, 29 May 2006, *TBH* 2008, afl. 1, 96.

[1121] As the employee of the bank who initially managed and administered the portfolio left the bank, another employee took over and requested a meeting with the client-investors. During the meeting, the investors were informed on the status of their portfolio and the risk they were exposed to if they continued to invest exclusively in shares. the meeting was held on 28 February 2002, two years after the strategy had been changed from 30 percent shares and 70 percent bonds to 100 percent investments in shares (25 March 2000).

Brussel, 27 April 2012, *JLMB* 2012, no. 25, 1203.

by the bank's mediation office, the claimants file claim against the bank in court. Considering the claim and the circumstances of the case, the Brussels appellate court decides that the bank-asset manager violated its duty of care because it did not duly warn the clients for the risks they were exposed to after changing the strategy from 30 percent shares and 70 percent bonds to 100 percent investments in shares. Finding that the fault was corrected two years later (February 2002), however, the court also considers that losses incurred since February 2002 should be borne by the investor-clients, as they were aware of the risks at that point in time, yet chose not to act on the bank's advice. The investor-clients could have prevented the further accumulation of loss after this point in time. As a consequence, the court fixates the recoverable loss as it stood on the 28th February 2002 and considers the client-investors responsible for the loss incurred after this point in time. Dutch courts have applied the duty to mitigate the loss to align risk and responsibility in a very similar manner. Following a claim against a financial advisor for unsuitable advice, the court held that losses suffered *after* the claimant realized that the investment was unsuitable due to its risk level should not be recoverable.[1122]

310. The role of the financial service provider with regard to the mitigation of damage. – Although the duty to mitigate the loss is a duty imposed on victims, i.e. investors suffering losses as a result of defective financial services in this context, it is repeated that investors can only carry out their obligation to react and intervene insofar they are aware of their duty to do so. In case an investor contacts his advisor, broker or asset manager to discuss a (potential) problem and a dispute arises, the financial institution should discuss the potential courses of action the investor can undertake, especially when it concerns unsophisticated investors.[1123] Moreover, in case the financial service provider recommends or advises the client-investor to keep the investments for the time being and wait whether or not potential improvements may occur, the investor cannot be held liable for additional losses in case the portfolio or investment continues to deteriorate.[1124] To the extent an investor is recommended to sell on the other hand, but does not act on the advice and decides to hold on to the investment and await improvements, further losses will not be considered recoverable and must be borne by the investor himself.[1125] Again, the consequences of investment decisions should be aligned with the ones bearing the responsibility for those decisions. It is repeated that financial service providers bear considerable responsibility when advising clients on investments and strategies and continue being responsible as long as the contractual relation continues, unless the investors disregards the advice or recommendations, or is consciously aware of a breach or irregularity, but fails to take corrective measures or notify the problem to the financial service provider.

C. Deduction of benefits

311. A final correction on the compensation to be awarded to aggrieved investors concerns the netting of the gains they may have received as a result of unsuitable investments, with the loss they claim to have suffered. The rule that benefits should be netted with the losses resulting from one and the same wrongful act is a common feature of the Member States' national liability laws and also

[1122] Hof Amsterdam, 15 May 2008, *JOR* 2008/305, (Heijmans/ING Bank NV).

[1123] The Netherlands: M. Van Luyn and E. Du Perron, *Effecten van de zorgplicht*, Deventer, Kluwer, 2004, 285; 't Hart, 'De maat van eigen schuld', 131; van Baalen, *Zorgplichten*, 424-425. See also: KCHB, 22 July 2003, 2003-55, *JOR* 2003/237; Switzerland: Rosat, *Der Anlageschaden*, 81.

[1124] Rb Amsterdam, 25 April 2012, LJN BW7099, available at www.rechtspraakzoeken.nl; Rb Leeuwarden 29 December 2010, *JOR* 2011/84, in particular r.o. 4.35-4.36.

[1125] Hof Amsterdam 15 May 2008, *JOR* 2008/305, (Heijmans/ING Bank NV), r.o. 4.23; Rb Amsterdam 13 April 2011, *JOR* 2011/224, (X./ABN Amro Bank NV); Hof ‘s-Hertogenbosch 16 December 2008, *JOR* 2009/164.

applies in the context of investment services.[1126] Gains that may be netted with the recoverable loss for instance include tax advantages, dividends, and other advantages that may be gained.[1127] Other deductions may involve amounts of money that have been withdrawn from the investments by investors over time. It has been commonly accepted that the deduction of benefits should be confined to those benefits that relate to the investments that are part of the breach for which the investors are demanding compensation. More particularly, in case a portfolio consists of unsuitable and suitable investments, the potentially positive result or other benefits that relate to the latter investments cannot be deducted from the loss that has been suffered as a result of the unsuitable investments.[1128] The difficulty in assessing the benefits that can be deducted generally concerns the delineation of the investments that relate sufficiently to the breach.[1129]

V. Conclusion: causation and damages for defective investment services

312. This part of the thesis discussed the application and interpretation of the requirements of causation and recoverable loss in the context of defective investment services. The first chapter concentrated on the assessment of transaction causation, i.e. the causal connection between a breach by financial service providers and the investment decision or investment strategy chosen by investors. Noting that difficulties related to causal uncertainty have arisen in several Member States, the techniques and approaches employed to deal with causal uncertainty were discussed. It was concluded that a shift of the evidential burden with regard to transaction causation is an appropriate solution, as it may contribute to the effectiveness of the rules of conduct, especially with regard to the prevention of mis-selling, while it still allows for a balanced judgment of the responsibility of both the investor and the financial service provider for the loss. More particularly, by means of the traditional doctrines and theories underlying the Member States' national liability laws, tailored and measured decisions can be handed down, apportioning damages for investment losses in line with the responsibility for their emergence. For instance, through the reconstruction of a hypothetical, alternative reference portfolio, the losses that would have invariably occurred in case suitable investments were chosen can be distinguished from losses incurred as a result of exposure to excessive risks due to violations of

[1126] Belgium ('*voordeelstoerekening'*): RONSE, *Schade en schadeloosstelling*, para. 519 ff.; BOCKEN and BOONE, *Schadevergoedingsrecht*, 224, para. 341. Germany: ('*Vorteilsausgleichung'*) GEIBEL, *Der Kapitalanlegerschaden*, 403; BAMBERGER, 'Anlageberatung', 1467, para. 186; SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 46 ff.; CASPER and ALTGEN, 'Germany', para. 4.129. The Netherlands: ('*voordeelstoerekening'*) art. 6:100 DCC; see also HARTKAMP and SIEBURGH, *Verbintenissenrecht. De Verbintenis in het Algemeen (tweede deel)*, para. 98; VAN LUYN and DU PERRON, *'Zorgplicht'*, 274; BUSCH and SILVERENTAND, 'The Netherlands', para. 7.160. See also (outside the EU): Switzerland: ROSAT, *Der Anlageschaden*, 114; CHAPPUIS, *Le moment du dommage*, 43; GROSS, 'Fehlerhafte Vermögensverwaltung, 165.

[1127] Idem.

[1128] SCHÄFER, SETHE and LANG (eds.), *Vermögensverwaltung*, §21, para. 46 and references cited.

[1129] Consider for instance a case brought before the Dutch Supreme Court in the aftermath of the securities lease controversy (*supra* para. 210). The dispute concerned an investor who had concluded five securities leasing contracts that left hims with considerable losses between 1997 and 2001, and three other, highly similar, securities leasing contracts that had turned out beneficial and left him with profitable results. Each of the investments had been concluded with the same bank-defendant and all of the investments were considered unsuitable and the result of a breach of the duty of care by the bank. The dispute and main question decided in the Supreme Court decision concerned the question whether the benefits that had been gained as a result of some of the securities lease investments could be deducted from the recoverable loss that had been incurred with the five other securities lease investments. The answer on the question was disputed as it concerned different contract, yet the factual circumstances were more or less identical, the breach was identical and the contracts and transactions were highly similar. In the light of the latter considerations, the Dutch Supreme Court held that the contracts could be considered to result from one and the same source, being the repeated breach of the duty of care to advise or recommend suitable investments, and because the contracts were closely related to each other. HR 29 april 2011, LJN BP4012, *JOR* 2011/190. See on this decision extensively: E.A.J. NEDERLOF, 'Het verrekenen van voordeel bij effectenleaseovereenkomsten', *MvV* 2011, nr. 10, 268.

financial service providers. By means of the doctrines of contributory negligence, the duty to mitigate the loss and the determination of the reference date, corrections can be applied.[1130]

313. Throughout the analysis of the case law, it was demonstrated that even though these principles may be commonly accepted across the Member States, the application of these principles in practice nonetheless reveals differences and leaves room for more consistency. With regard to the doctrine of the loss of chance in the context of investor losses, a lack of uniformity and consistency was observed, not in the least because most of these decisions appear to be based on *ex aeqo et bono* assessments without reference to the reasons and factors that were taken into account to reach a certain decision. The difficulties related to the numerical quantification of the likelihood that the loss would not have occurred absent the wrong, demonstrate that the alternative approaches developed under the doctrine of the loss of a chance and the proportional liability doctrine essentially shift the problem of causal uncertainty to the level of the calculation of the damages. As pointed out in the French scholarly literature, this solution essentially solves the problem by awarding a lump sum to cover part of the claimed loss by investors and allow for arbitrariness and inconsistency.[1131] As courts are required to assess the loss as accurate and precise as possible to avoid over- or under-compensation of investors[1132], the reconstruction of a hypothetical alternative by means of reference portfolios, if necessary with the assistance of experts, offers a more sound and balanced solution from this perspective.

314. A final remark concerns the occurrence of mass mis-selling cases, such as the Dutch securities leasing controversy. In case thousands of claims arise following a mis-selling scandal on a mass scale, it is evident that assessments of transaction causation and the reconstruction of hypothetical reference portfolios for thousands of individual investors with different profiles and preferences, is nearly impossible. In these cases, a presumption of transaction causation becomes inevitable, as the Dutch Supreme Court seems to have realized in the securities leasing controversy.[1133] To facilitate the assessment of the recoverable loss in a mass litigation context, courts – and higher courts in particular – may consider designing hypothetical alternatives depending on the various types of investors that may claim compensation. For instance, confronted with thousands of claims flooding the Dutch courts and giving rise to diverging case law, the Amsterdam Court of First Instance developed the category-model, according to which damages were awarded to aggrieved investors depending on the category or type of investor.[1134] More particularly, depending on criteria such as (professional) investment experience, financial capacity, annual (net family) income and general education level, the court distinguished four categories of investors. The first category included investors who lack investment experience (both professional and other), who did not have an income of their own (or as good as

[1130] VANDENDRIESSCHE, 'Causaliteit en bewijslast', 214-215.

[1131] See references cited ftn. 1025.

[1132] See *supra* para. 138.

[1133] HR 5 June 2009, LJN BH2822, (Stichting Gedupeerden Spaarconstructie/Aegon), *JOR* 2009/200 and *RvdW* 2009, 685; LJN BH2815, (X./ Dexia Bank Nederland N.V), *JOR* 2009/199 and *RvdW* 2009, 683; LJN BH2811, (Levob Bank N.V/X.), *RvdW* 2009, 684. See also *supra,* para. 210.

[1134] Rb Amsterdam 27 April 2007, LJN BA3914, (X./Dexia Bank Nederland); LJN BA3916, (X./Dexia Bank Nederland), both decisions available at http://zoeken.rechtspraak.nl. For other applications and decisions adopting or using the model, see: Rb Alkmaar 5 September 2007, LJN BB3112, (X./ DSB BANK N.V.); and LJN BB3107, (X./ DSB BANK N.V.), *JOR* 2007/152 and 153 with ann. by J. A. VOERMAN; both decisions also available at http://zoeken.rechtspraak.nl; Rb Amsterdam 13 June 2007, LJN BB2214, (X./Dexia Bank Nederland), available at http://zoeken.rechtspraak.nl.; Rb Zwolle 11 September 2008, LJN BF0062, (X./Dexia Bank Nederland), available at http://zoeken.rechtspraak.nl; Rb Amsterdam 27 June 2007, LJN BB1952, (X./Dexia Bank Nederland), available at http://zoeken.rechtspraak.nl; Rb Amsterdam 6 June 2007, LJN BB2240, (X./Groeivermogen N.V. and Fortis Bank Nederland NV), available at http://zoeken.rechtspraak.nl.

none) and whose net family income on an annual basis was below a certain specified standard. These investors were considered the ones who should have been most strongly advised against investments with borrowed money, and thus the ones who should have been recommended far more safe products, according to court. As a result, these investors were entitled to a higher amount of compensation compared to the other categories of investors.

Along those lines of thinking, courts or other authorities involved in the treatment of mass claims may design hypothetical alternatives depending on the type of investor, modeled after the circumstances and details of the specific mass litigation, and streamline the outcome of the claims in a consistent and uniform manner. Again, as has been recurrently observed and demonstrated throughout this part of the thesis, the degree of investor sophistication measured by means of investment experience, level of education, knowledge financial strength and other mentioned criteria will prove highly relevant in these assessments.

PART III. THE CONCEPT OF CAUSATION AND RECOVERABLE LOSS IN THE CONTEXT OF DEFICIENT MARKET DISCLOSURES

315. Investor claims following deficient issuer disclosure entail complaints for losses allegedly caused by the sale, the purchase or the mere holding of securities to which the misinformation relates. With regard to causation, loss and the damages that may be claimed two different approaches can be distinguished. Firstly, causation and loss can be assessed and applied in a more or less identical manner as is the case in the context of investment services litigation. This approach focuses on the causal link between information and investment decisions and assumes that to the extent investors are empowered and adequately informed and advised, they are able to make autonomous investment decisions for which they bear responsibility. To the extent the information or advice they receive is flawed and fails to inform the investor adequately, the financial service provider is held responsible for the result of distorted investment decisions. Similarly, in the context of wrongful market disclosures, it was observed that one of the goals underlying the EU and national disclosure regulation concerns the provision of adequate information to the investor public.[1135] In this setting, it is again assumed that to the extent that investors are erroneously informed, they may end up making investment decisions they would not have made absent the wrong. This approach to causation and loss, based on the assumption that deficient market disclosures distort investment decision processes is referred to as the transaction model for the remainder of this thesis, as it focuses on effecting transactions that would not have been made absent the deficient information. In this model, causation is again analyzed in a two-pronged framework consisting of transaction and loss causation, leading to difficulties and problems that are very similar – if not identical –to those discussed in the context of investment services. Yet the methods and solutions developed by courts, legislators and literature diverge to a certain extent, as will be shown in the first chapter.

316. In the second chapter, an alternative approach to causation and damages for losses suffered following erroneous capital market information is analyzed. Other than the traditional approach, this alternative model no longer focuses on the interaction between investment decisions and capital market information, but instead addresses the interaction between the securities pricing mechanisms and information. This alternative model, referred to as the market model, originated in US courts and has developed into a legal doctrine in the US, being the fraud on the market-doctrine. The impact of the fraud on the market-doctrine reaches far beyond the US borders as it has set an example and has brought courts in Europe, Australia and Canada to consider the doctrine as well as the underlying model within their own legal frameworks. As some of the EU Member States have (rather recently) started to implement this alternative approach to loss and causation, the US-doctrine is examined on its merits and relevance for an EU context in a final part of this thesis.

[1135] *Supra*, Part I, Chapter I, para. 13 ff. on the information paradigm.

CHAPTER I. THE CONCEPTS OF LOSS AND CAUSATION IN THE CONTEXT OF DEFICIENT ISSUER INFORMATION: TRANSACTION MODEL

I. The concept of causation in the transaction model

A. Transaction causation in the light of deficient issuer information: general overview

317. Transaction causation in the context of deficient issuer disclosure implies that in the event that issuer had not breached his disclosure obligations, the investor-claimant would not have purchased, sold or continued to hold the securities. This requires that an aggrieved investor read or was otherwise aware of the wrongful information and, second, that he relied and acted on the information, in the sense that it was material to his decision to purchase, sell or hold the securities at matter. In case the misrepresentation concerns omitted information, courts will examine whether the information was material and whether the aggrieved investor would have relied on it in the light of the circumstances of the case.

1. The requirement of having read the misleading information

318. Contrary to asset managers and financial advisors, issuers usually do not communicate in a personal and direct manner to investors, but instead inform the investor public through publicly disclosed information. Whether investors actually read, or became otherwise aware of the publicly disseminated information is often hard to find out. Apart from occasional examples[1136], establishing proof of having read the information is often very cumbersome and a threshold too high to meet for investors.[1137] Moreover, whereas reliance on investment advice from a professional is not implausible since investor-clients mostly turn to professionals specifically to obtain information and recommendations tailored to their individual profile, reliance on issuer disclosure is harder to assume since it is generally believed that the majority of (retail) investors do not (thoroughly) read and process (or understand the technicalities contained in) financial information documents prior to making investment decisions.[1138]

[1136] (France) CA Colmar, 14 October 2003, n° 1 A 01/03432 X c/SA Eurodirect Marketing, *Bull. Joly Bourse* 2004, §89, 467-472, with ann. by G. DOLIDON, *Bull. Joly Bourse* 2004, §89, 472-477 (*Eurodirect*); (Belgium) Kh. Brussel 16 April 1996, *R.P.S.* 1996, 431-443, annoted by B. FERRON (*Bank Nagelmaekers*); see also: X. DIEUX, 'Examen de jurisprudence', *R.C.J.B.*, 2004, (207) 257; S. BOGAERTS K. VANDERHEYDEN, B. CLERCKX, P. D'HONDT EN G.M. GOLLIER, *Openbare aanbiedingen en prospectus: de wet van 16 juni 2006*, Brugge, Vanden Broele, 2007, 305 ff.; VANDENDRIESSCHE, 'Fraud-on-the-market', para. 48 ff.

[1137] (Belgium) VANDENDRIESSCHE, 'Fraud-on-the-market', 277; RAVELINGIEN, Privaatrechtelijke handhaving, 427; V. DE SCHRIJVER, 'Prospectusaansprakelijkheid', E. WYMEERSCH, *Financieel recht tussen oud en nieuw*, Antwerpen, Maklu, 1996, 351. (France): SPITZ, *La réparation*, 325-326. See also: (Germany) T.M.J. MÖLLERS, §69 Organhaftung, P. DERLEDER, K.-O. KNOPS and H.G. BAMBERGER, *Handbuch zum deutschen und europäischen Bankrecht*, Berlin, Springer, 2009, (2099) 2105, para. 18; L. LEUSCHNER, 'Zum Kausalitätserfordernis des § 826 BGB bei unrichtigen Ad-hoc-Mitteilungen', *ZIP* 2008, heft 23, 1050. (the Netherlands) DE JONG, *Schade door misleiding*, 100, 189, 389.

[1138] KRIPKE, 'The myth of the informed Layman', 631-639; KRIPKE, 'New Approaches to Disclosure in Registered Security Offerings: A Panel Discussion', 505-536; KRIPKE, 'A search for a Meaningful Securities Disclosure Policy', 293-318. See also: W.O. DOUGLAS, 'Protecting the Investor', 23 *Yale Rev.*, 1934, 523-24 (1934): "[E]ven though an investor has neither the time, money, nor intelligence to assimilate the mass of information in the registration statement, there will be those who can and who will do so, whenever there is a broad market.". See furthermore: SCHAEKEN WILLEMAERS, *EU Issuer-Disclosure Regime*, 35 ff.; PEARSON, 'Reconceiving Regulation: financial literacy', 45-58; HALPERN and PURI, 'Reflections on the Recommendations of the Task Force to Modernize Securities Legislation in Canada', 214 ff. *Comp.*: GALLERY and GALLERY, 'Rethinking financial literacy in the aftermath of the global financial crisis', 30-50.

319. Confronted with investors' struggles in this regard, courts have repeatedly eased the evidential requirement or displayed lenience when assessing transaction causation in this context.[1139] Reference can be made to the Belgian appellate court decision handed down in a case concerning misleading prospectus information (*Barrack Mines*). Contrary to the aforementioned widespread feeling that (retail) investors generally do not read prospectuses[1140], the appellate court considered transaction causation established with the (brief) statement that it could be assumed that the average investor reaches a decision after having properly informed himself on an investment.[1141] A similar causal presumption applicable to investor claims in the context of prospectus liability was adopted in a relatively recent Dutch Supreme Court decision.[1142] In a French court decision on the other hand, the claimant's argumentation was accepted that he had not read the deficient information, but was nonetheless indirectly influenced by the misinformation as he decided to buy securities in response to the price increase prompted by the falsely optimistic information.[1143] In some jurisdictions, legislators also intervened, though mostly with regard to prospectus liability. For instance, in Germany, the UK and Belgium, statutory provisions have been enacted aimed at appeasing the evidential burden related to causation in prospectus liability claims. The various techniques and measures developed in courts and/or embedded in statutory law are discussed further below.

2. Reliance on the deficient information

a. Materiality versus reliance

320. In a strict approach to transaction causation the investor-claimant is not only required to read the information, the information must also affect – or in case of an omission, would have affected – the decision process. It was already explained in one of the previous chapters that the impact of information on investment decisions can be considered on two levels.[1144] More particularly, the misleading character of the information may be assessed on an abstract, theoretical level, based on whether an average and reasonable investor would have been influenced by the deficient information, or on a factual concrete assessment of whether the particular investor in the case brought before the court was mislead. It was also noted that even though an abstract assessment of the material nature of the misinformation may facilitate the analysis, courts in the Member States have displayed reluctance

[1139] See for instance also the Swiss Federal Supreme Court that facilitated the establishment of causation by holding that an investor is not necessarily required to establish proof that he read the prospectus. Instead, an investor can also succeed in establishing causation by showing that he bought the securities pursuant to the positive market sentiment caused by the misleading prospectus. This essentially comes down to the adoption of the German doctrine of *Anlagestimmung.* Schweizerisches Bundesgericht (Swiss Federal Court), 28 August 2006, BGE 132/2006 III 715, also available at: http://www.bger.ch/. See for comments on this decision: P. LOSER, 'Switzerland', H. KOZIOL and B.C. STEINIGER, *European Tort Law 2006*, Volume 2006, Vienna, Springer, 2008, 478-480; see also (more extensively): M.G. CARBONARE, H HARRER, T. SPILLMAN and F. WIRTH, 'Liability and due diligence in connection with equity securities offerings', *GesKR*, 2008, no. 2, (119) 129; and: C. CHAMMARTIN and H.C VON DER CRONE, 'Kausalität in der Prospekthaftung', *SZW/RSDA*, 2006, heft 6, 452-460; WEBER, 'Anlägeschaden', 152.

[1140] See the references cited in ftn. 1138.

[1141] "In eerste instantie moet van de doorsnee belegger worden aangenomen dat hij zijn beslissing treft nadat hij zich behoorlijk heeft geïnformeerd bij alle bronnen die de financiële markt biedt."; Brussel 3 October 2006, *DAOR* 2007, 227-238, with ann. by: S. DELAEY.

[1142] HR 27 November 2009, *JOR*, 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht*, 2010, 21, with ann. by H.M. VLETTER-VAN DORT.

[1143] CA Paris, 11^{e} Ch., 20 December 1990, cited in a comment by M. JEANTIN & A. VIANDIER, Part II Droit Boursier, *RD. Bancaire*, 1991, n° 24, 69-70.

[1144] *Supra* para. 164.

to assess causation on an abstract and general basis because loss and causation must generally be appraised in the light of the concrete facts of the case.[1145]

b. Assessment of reliance: criteria

321. The criteria used by the courts to analyze reliance in deficient market disclosure cases are not always entirely clear. Courts often remain fairly vague in their motivations or reasoning on reliance, partly because causation generally proves to be a highly factual matter. For instance in the UK, courts have expressed a preference to treat causation as a mere factual element, to be assessed in the light of the circumstances of the given case instead of formulating 'tests' or establishing formal criteria to assess causation. In *Galoo Ltd v. Bright Grahame Murray* it was even acknowledged that courts use common sense as guidance to assess causation, rather than establish and apply a formal legal test.[1146]

322. Another explanation for clouded assessments and conclusions without clear indications as to the facts and evidence supporting the conclusion, however, lies with the difficulty courts encounter in assessing the highly subjective nature of reliance.[1147] For example, in its decision in *Coop AG* concerning allegedly misleading prospectus information, the Amsterdam Court of Appeal confirmed that "it can be considered acceptable that losses have been suffered […] insofar that loss, as a consequence of the misleading advertisement, cannot be considered to be part of the ordinary investment risk and it can be assumed that the investor relied, or partly relied, on the prospectus".[1148] The decision offered no further indications clarifying how an investor is to prove (partial) reliance, nor how courts are to assess reliance. Similarly, in its judgment on the *Philips/VEB* case concerning erroneous ad hoc information, the Dutch Supreme Court decided that "with respect to those who relied on the information, the issuer was to be held responsible"[1149], yet a further reasoning elaborating on the court's reasons to assume reliance on the side of the investors in the given case was absent.

[1145] Idem.

[1146] Galoo Ltd. v. Bright Grahame Murray e.a., (1994), 1 W.L.R. 1360, at 1370, citing the literature as follows: "courts have avoided laying down any formal tests for causation: they have relied on common sense to guide decisions as to whether a breach of contract is a sufficiently substantial cause of the plaintiff's loss. (It need not be the sole cause)." (*Chitty on Contracts*, 26th ed. (1989), vol. 2, pp. 1128–1129, para. 1785). See in the same sense regarding causation: *Yorkshire Dale Steamship Co. Ltd. v. Minister of War Transport*, (1942), A.C. 691, at 706, *per* Lord WRIGHT. See also: FERRAN, 'US-style investor suits', 7. In this context reference can also be made to *Rushmer v. Mervyn Smith*, where the claimant sued his company's auditor for overstating the profit and assets of the company, allegedly causing the claimant to continue the trade and invest additional money in the company instead of winding it down, as he claimed he would have done had the truth been known. Considering the facts of the case however, the court concluded that it could not accept that the claimant, an experienced businessman, had reasonably believed the grossly overstated accounts to be correct. *Duncan David Bruce Rushmer v. Mervyn Smith* (trading as Mervyn E Smith & Co), (2009) WL 6541; EWHC 94 (QB), at 63-64.

[1147] TGI, Paris, 11th Ch., 27 February 1998, (*Sedri*) *Bull. Joly Soc.* 1998, §291, 925; with ann. by N. RONTCHEVSKY. See in the same sense: SPITZ, *La réparation*, 235, ftn. 74; Belgium: Brussel 9 September 2003, (*Varde*) *Bank. Fin. R* 2005 (shortened), 332-335, with ann. by L. VAN DEN STEEN.

[1148] Translation based on the text in: Hof Amsterdam, 27 May 1993, *NJ* 1993, 682 (*Coop AG*), at r.o. 5.16. See for this case also: R.E. DE ROOY, *Emissies op de Nederlandse markt*, Deventer, Kluwer, 1996, 101 ff.; C.J.H. JANSEN, E.R. SCHREUDER and H.L.E. VERHAGEN (eds.), *Prospectusaansprakelijkheid*, Amsterdam, NIBE-SVV, 2003, 89; G.T.J. HOFF, 'De lessen van het Co op-Arrest', S. C. J. J. KORTMANS, N. E. D. FABER, A.A. VAN ROSSUM and H.L.E. VERHAGEN, *Onderneming en 5 jaar nieuw burgerlijk recht*, Haarlem, Tjeenk Willink, 1997347-274; A.F.J.A. LEIJTEN, 'Prospectusaansprakelijkheid', *NV*, 1995, afl. 73 214-224; L. VAN DE BRAAK, 'Van Kannenbier tot Coop: een overzicht van prospectusaansprakelijkheid', L. TIMMERMAN and H. BOSCHMA, *LT: verzamelde 'Groninger' opstellen aangeboden aan Vino Timmerman*, Deventer, Kluwer, 2003, 23 ff. Even though the Coop AG case was eventually decided by the Dutch Supreme Court, no opinion was expressed with regard to the establishment of causation since this element was not disputed anymore before the Supreme Court (). See in this regard also HOFF, who considers the decision a missed opportunity to discuss the requirement of causation and the approach taken by the appellate court of Amsterdam in the Coop AG case (HOFF, 'De lessen van het Co op-Arrest', 368). See for the Supreme Court decision: HR 2 December 1994, *NJ* 1996, 246 (*Coop AG*).

[1149] HR 7 November 1997, *NJ* 1998, 268, with ann. by J.M.M. MAEIJER. Philips had disclosed information too optimistic, allegedly inducing the claimants to invest in Philips securities.

Moreover, in its decision on *Boterenbrood/Mees Pierson* concerning two investors who purchased shares in a Canadian partnership via an investment fund, allegedly pursuant to a misleading prospectus, the court's decision even fails to mention the causal analysis.[1150] These Dutch examples are no outliers. Reported French and Belgian court decisions following violations of capital market disclosures have shown similar inconsistencies and ambiguities with regard to causation and reliance.[1151] Spurred by a series of scandals and fraud, the German '*Bundesgerichtshof* 'has been pressed to provide answers and solutions to the problem of transaction causation in issuer liability cases, whereas the lack of UK cases – notwithstanding the prominent role UK markets play as financial centre – has added to the general feeling that there is room and need for a more developed doctrine on liability for erroneous capital market disclosures.[1152] As courts (and investors) often struggle with the requirement of causation, a consistent and well understood concept of causation implemented in an adjusted procedural framework can contribute to the development of a more sound and consistent legal framework. Recent developments – both in case law and in statutory law – show a range of paths as to how solutions to the causal uncertainty may be constructed. These solutions can be situated both on the procedural level – such as lowering of the burden of proof, the introduction of presumption and the like – but also in terms of substantial law and more particularly concern the concepts of causation and loss. In this chapter, we explore the techniques applied to solve or ease the problems associated with the concept and evidential difficulties in relation to transaction causation in issuer liability cases. In line with statutory law and case law, the analysis of causation and recoverable loss pursuant to erroneous capital market information draws the distinction between prospectus liability on the one hand, and liability for breaches of continuous reporting obligations on the other.

B. Transaction causation in the context of prospectus liability

323. A comparative analysis of the techniques developed and applied in the context of prospectus liability shows that courts and legislators have predominantly taken resort to the introduction of (rebuttable) presumptions of causation. The influential doctrine of '*Anlagestimmung*', developed by the German courts is a notable example in this regard.[1153] Prior to the enactment of specific prospectus

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[1150] HR 8 May 1998, (Boterenbrood/Mees Pierson), *NJ* 1998, 888. See also: VAN BAALEN, *Zorgplichten*, 270 ff. See also: L. TIMMERMAN, comment on Boterenbrood/Mees Pierson in *TVVS* 1998, 207 ff. The author critically casts doubts on the assumption that the investor-claimants would have decided differently in case the prospectus would have mentioned the obligation to pay part of the outstanding debt of the fund upon withdrawal. He particularly questions the relevance of a single condition on the whole of the information packet, provided in the prospectus. The author also doubts whether the investor-claimants are sufficiently experienced and sophisticated to understand and assess the implications of a legal condition which would only apply to them in certain, rather exceptional, circumstances. The author instead considers the expected return of considerable importance to an average investor, rather than complicated and specialized legal terms and conditions requiring a certain (legal) background to make accurate assessments. The most recent decision of the Dutch Supreme Court however adopted a presumption of transaction causation to be applied in prospectus liability cases. The decision is elaborated on further below.

[1151] Note that with regard to France, it was found that litigation pursuant to deficient issuer information is a relatively recent phenomenon and has been notoriously absent until the end of the nineties. SPITZ for instance points out that in the 20th century, issuer liability cases were rare. This changed in the last two decades, during which a significant increase took place. See: SPITZ, *La réparation*, 209 and 235, ftn. 74; and PIETRANCOSTA, 'Délits boursiers', 21-27. Reported court decisions concerning liability for deficient issuer information are even more rare in Belgium. Even though some cases have been initiated and decided in the aftermath of the financial crisis, investor litigation pursuant to deficient capital market information remains relatively rare. See in a broader EU context also: RINGE and HELLGARDT, 'International dimension', 29. The authors assert that European secondary market liability is still in a state of development.

[1152] See also: ARMOUR, 'Enforcement strategies', 17-18; ARMOUR, BLACK, CHEFFINS and NOLAN, 'Private enforcement of corporate law', 689; FERRAN, 'US-style investor suits', 3; VEIL, *Europäisches Kapitalmarktrecht*, 215-216, 371.

[1153] The term '*Anlagestimmung'* can be translated as 'market sentiment'. See on this topic also: P. BUCK-HEEB, *Kapitalmarktrecht*, Heidelberg, Müller, 2009, 165, para. 195; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 137;

liability rules, the doctrine was highly relevant for German investors filing suit for damages pursuant to misleading prospectus information and drew attention from legislators and literature in other EU countries as well.[1154] Given its relevance and impact in Germany and beyond, the doctrine is briefly explained in the following. It is noted that as of today, however, the doctrine has been substituted (to a considerable extent) by the statutory presumption of causation in §21 WpPG (formerly §§44-45 Stock Exchange Act).[1155]

1. The introduction of rebuttable presumptions of causation/reliance

a. The German doctrine of 'Anlagestimmung' and the statutory presumption of §21 WpPG

324. The '*Anlagestimmung'*-doctrine holds that misleading prospectus information that puts the issuing company in a more favorable light may create an excessively positive market sentiment (or even frenzy) amongst the investor public, causing the latter to subscribe to the offering.[1156] The causal connection between the misleading information and investment decisions of investors is hence derived from the positive market mood that has been created by the misleading information.[1157] From this perspective, it is no longer needed that investors actually read the misleading prospectus information and that they relied on it. Instead, the courts accept an indirect link between the information and the investment decision, derived from the positive market mood that has been created by the misleading information.[1158] The '*Anlagestimmung'*-doctrine became widely applied in German courts and eventually resulted in the enactment of a statutory presumption of causation by the German legislator.

325. A rebuttable presumption of causation was first enacted in the former §§44-45 Stock Exchange Act and later replaced by the current German Securities Prospectus Act ('*Wertpapierprospektgesetz'* or "WpPG").[1159] According to §21and §23 WpPG, a causal relation between erroneous prospectus information and the purchase of securities is presumed, provided that the investor subscribed to the securities within six months since the publication of the misleading

GEBAUER, *Hypothetische Kausalität*, 296; GEIBEL, *Der Kapitalanlegerschaden*, 196; BARTH, *Schadensberechnung*, 165; HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §28, para. 35.

1154 The term '*Anlagestimmung'* can be translated as 'market sentiment'. See on this topic also: BUCK-HEEB, *Kapitalmarktrecht*, 165, para. 195; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 137; GEBAUER, *Hypothetische Kausalität*, 296; GEIBEL, *Der Kapitalanlegerschaden*, 196; BARTH, *Schadensberechnung*, 165; HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §28, para. 35.

1155 See with regard to §21 WpPG, formerly §44 and § 45 BörsG, also *supra*, para. 177 (general, comparative overview).

1156 See extensively on the concept and application of 'Anlagestimmung': HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 137; GEBAUER, *Hypothetische Kausalität*, 296; BARTH, *Schadensberechnung*, 164 ff. See also in the case law: BGH, 12 July 1982, *NJW* 1982, 2827; *WM* 1982, 967; BGH, 19 March 1996, *NJW* 1996, 1828 (VI ZR 380 / 94); BHG, 14 July 1998, (XI ZR 173/97) *BB* 1998, 2071; 19 *ZIP* 1998, 1531.

1157 In Germany, this considered is an application of the so-called "*Anscheinsbeweis*" by some, the reversal of the burden of proof by others. See for instance: S. RICHTER, *Schadenszurechnung bei deliktischer Haftung für fehlerhafte Sekundärmarktinformation*, Tübingen, Mohr Siebeck, 2012, 89-92; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 137; GEBAUER, *Hypothetische Kausalität*, 295-296.

1158 See in this regard also: VEIL (ed.), *European capital markets law*, 240-241.

1159 The Act on the Drawing up, Approval and Publication of the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading on an Organized Market (German Securities Prospectus Act) was enacted in 2005 to implement the EU prospectus Directive and amended in 2012. The amended version includes the causal presumption applicable in prospectus liability cases, formerly stated in §§44-45 BörsG. See in this regard: Gesetz zur Novellierung des Finanzanlagenvermittler- und Vermögensanlagenrechts vom 6 December 2011, BGBl. I s. 2481.The amendments came into force on June 1st, 2012. See on the changes, including the implementation of the amended EU Prospectus Directive (2010): HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 6 ff.

prospectus.[1160] This implies that investors are no longer required to establish the existence of a positive market sentiment and that the purchase of the claimant-investor is assumed to have taken place in reliance on the correctness of the prospectus information.[1161]

Defendants can rebut the presumption by presenting evidence that the decision to acquire the securities is not based on the prospectus or that the investor was aware of the inaccurateness or incompleteness of the prospectus information at the time of acquisition.[1162] The presumption can also be rebutted when evidence shows that no positive market sentiment prevailed (anymore) at the moment of purchase.[1163] For instance, in case information rectifying the wrongful information was disseminated through supplementary or ad hoc disclosures, or a sharp price decline occurred, the market mood may change and adjust to the corrected information.[1164] Furthermore, is noted that transaction causation as such is not sufficient to obtain recovery. If the defendant presents evidence that the misinformation neither caused nor contributed to the decline in value of the shares at matter, the investor will not be compensated for any loss suffered.[1165] This only applies if the loss of investment value is exclusively due to external, unrelated facts.[1166]

b. The UK and Belgium: statutory presumptions of reliance

[1160] §21 WpPG holds that securities acquired within six months following the introduction of the securities are considered to have been acquired based on the prospectus. §23 WpHG specifies on which grounds liability is excluded for prospectus liability, and for instance holds that no liability arises based on §21 and §22 WpPG unless the wrongdoer was aware of the wrongful information, or has been grossly negligent, or in case the acquirer knew the information was inaccurate or incomplete. ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 233 ff.; BARTH, *Schadensberechnung*, 164; MAIER-REIMER/SEULEN in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 35 ff.

[1161] The impact of the German doctrine of '*Anlagestimmung'* has not been entirely erased by the aforementioned statutory law however. The current Belgian (statutory) presumption of causation was inspired by the German doctrine, while both the Swiss and Austrian courts have been influenced as well. The Swiss Federal Supreme Court for instance held that an investor is not required to establish proof that he read the prospectus. Instead, an investor can also succeed in establishing causation by showing that he bought the securities pursuant to the positive market sentiment caused by the misleading prospectus. The influence of the German doctrine is obvious, although the Swiss court refused to go as far as establishing a presumption. Instead it was decided that under Swiss law, claimants remain to bear the burden of proof, even though no strict proof is required and a lowered burden of proof is to be applied in the context of prospectus liability. Instead of evidence supporting the claim with a probability close to certainty, a client can suffice with the less demanding establishment of probability of causation suffices (referred to as *'überwiegende Wahrscheinlichkeit''*) in prospectus liability cases. See: Schweizerisches Bundesgericht (Swiss Federal Court), 28 August 2006, BGE 132/2006 III 715, also available at: http://www.bger.ch/. See for a comment on this decision: LOSER, 'Switzerland', (474) 478-480; see also (more extensively): CARBONARE, HARRER, SPILLMAN and WIRTH, 'Liability and due diligence in connection with equity securities offerings', 129; WEBER, 'Anlägeschaden', 152; CHAMMARTIN and VON DER CRONE, 'Kausalität in der Prospekthaftung', 452-460.

[1162] §23 (2) (1) and (3) WpPG.

[1163] ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 234; HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 90 ff.; see also in this respect: SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, §§ 44, 45, para. 47 ff.; MAIER-REIMER/PASCHOS IN HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §28, para. 37; VEIL (ed.), *European capital markets law*, 241; MAIER-REIMER/SEULEN in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 37.

[1164] Idem. Reported case law shows that the market mood may also change (and the presumption hence rebutted) when the securities were acquired after the issuer requested bankruptcy proceedings, negative economic trends had been forecasted, negative changes in the exchange index occurred, the price collapsed etc. See in this regard MAIER-REIMER/SEULEN in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 37 and references to reported case law cited in the accompanying footnotes.

[1165] §23 (2) (2) WpPG. As long as the loss of investment ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 242; SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, §§ 44, 45, para. 58; WAGNER, 'Schadensberechnung', 498; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 98-99; U EHRICKE, 'Deutschland', 238-240.

[1166] In case the misrepresentation has caused the investment to lose part of its value, however, causation is established. ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 242; SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, §§ 44, 45, para. 58; WAGNER, 'Schadensberechnung', 498; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 98-99; EHRICKE, 'Deutschland', 238-240.

326. Purpose of the statutory presumptions. – Whereas the German statutory presumption of causation essentially followed the evolution put in motion by established court practices, the Belgian and UK legislator seized the transposition of the EU Prospectus Directive as an opportunity to introduce a presumption of causation, or a presumption of reliance as it is referred to in UK context. Although the directive does not oblige the EU Member States to provide for such a presumption or even to facilitate investor claims, these Member States considered the introduction of causal presumptions nonetheless appropriate or even necessary.[1167] The motivation for the introduction of statutory presumptions in the UK and Belgium lies with the finding that investor-claimants who filed suits for losses allegedly resulting from misleading prospectus information too often saw their claims rejected due to the high burden of proof related to the requirement of causation. This not only prevented investor-claimants to obtain compensation, which was considered problematic from an investor protection point of view, but also gave much leeway to issuers who manifestly violated the prospectus regulation. Or in other words, a deterrent effect could be added by providing for a stronger investor enforcement system.

327. Scope and impact: comparative overview. – The Belgian statutory presumption resembles the original German *Anlagestimmung*-doctrine. More particularly, the Belgian statutory presumption of causation laid down in the Prospectus Act (2006) shifts the burden of proof to the defendant, provided that the investor presents proof that the misstatement or omission either caused a positive market sentiment, or that it had an impact on the market price.[1168] This latter condition implies that in order to establish causation, the prospectus must have misled the market as a whole, including the investors.[1169] Hence, investors no longer need to establish proof that they read and relied on the prospectus. In the – rather unlikely – event that the defendants succeed in establishing that the investor(s) did not rely on the misrepresentation, for instance because they knew the information was inaccurate or incomplete, the presumption may be rebutted. Whether the loss is recoverable in case the defendants prove that the loss has been (partially) caused by other factors than the (revelation of the) misrepresentation is unclear.[1170]

328. Contrary to its Belgian and German equivalents, the UK regime does not expressly provide for a presumption of (transaction) causation in case an investor bought securities following misleading prospectus information or listing particulars. Instead, s.90 FSMA states that a person responsible for listing particulars and the prospectus is liable for losses suffered *as a result* of incorrect or incomplete prospectus information. Although the statutory text is not explicit about it on its face, it is clear that s.90 FSMA is to be interpreted as a presumption of reliance.[1171] HUDSON for instance finds support for this interpretation based on the purpose of s.90 FSMA, being the facilitation of investor claims on

[1167] The Belgian draft motivates the introduction of the presumption by reference to the difficulties investors encounter and mentions the UK and German legal system as examples of jurisdictions that offer similar facilitations for those reasons. *Parl. St.*, Kamer 2005-2006, Doc 51, nr. 2344/001, 2345/001, p. 74-75. With regard to the UK, see: HUDSON, *Securities Law*, 572, para. 23-03; ALCOCK, 'Misinforming the market', 247.

[1168] Art. 61 §2, §4 Prospectus Act. See also: RAVELINGIEN, Privaatrechtelijke handhaving, 427.

[1169] S. DELAEY, "Noot Barrack Mines: het vervolg" (annotation of Brussel 3 October 2006), *DAOR* 2007, 237. This liability regime is very similar to the German approach to prospectus liability according to the '*Anlagestimmung'*-case law as it was applied before the enactment of the former §44 BörsG – now §21 WpPG (see *supra*: para. 324).

[1170] See on loss causation and recoverable loss *infra,* para. 351.

[1171] HUDSON, *Securities Law*, 23-15 – 23-16; ALCOCK, 'Misinforming the market', 249, ftn. 33, and 251; DAVIES, *Principles of Modern Company Law*, 25-32; HUDSON, *Charlesworth's Company Law*, 14-016; FERRAN, 'US-style investor suits', 326; P.L. DAVIES and S. WORTHINGTON, *Gower and Davies' Principles of Modern Company Law*, London, Sweet and Maxwell, 2012, 931, para. 25-33.; CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, 400, para. 7.52.

misleading prospectuses.[1172] Others endorse this point of view by making reference to the exemptions in the schedule that accompanies this regulation.[1173] Schedule 10 para 6 FSMA[1174] more particularly holds a specific defense for the issuer that clarifies that in case an investor did not rely on the misleading information, no liability can be imposed.[1175] In other words, the schedule leaves it to the issuer to present evidence that the investor did not rely on the misleading information. This interpretation has been confirmed by the DAVIES-report that aimed to assess the UK issuer liability regime with regard to the formulation of new regulation.[1176]

The scope of s.90 FSMA is limited to reliance, implying that even though reliance is presumed, loss causation still needs to be established.[1177] This essentially comes down to a facilitation of the establishment of causation in the sense that the investor is not required to present proof of having read the prospectus or having relied on the deficient information.[1178] A causal nexus between the misleading information and the claimed loss (loss causation) is still required however, and can be met with proof that the misstatement or omission had an impact on the market price.[1179] With regard to the establishment of this evidence, it should be noted that although no time limits are provided for in s.90 FSMA, it can be assumed that the more time elapses between the misinformation and the transaction, the more difficulties the investor-claimant is expected to encounter since a multitude of factors may impact the price significantly over time.[1180]

c. Transaction causation in the light of the Prospectus Directive: World Online

329. The Dutch Supreme Court also adopted a (rebuttable) presumption of reliance, yet it based the adoption of the presumption directly on the European Prospectus Directive and especially on its duty to render EU prospectus rules effective ('*effet utile*').[1181] The Dutch Supreme Court acknowledges and

[1172] HUDSON, *Securities Law*, 23-15 – 23-16.

[1173] COUSINS and CHARMAN, 'Misrepresentation on bond issues: liability in the secondary market', 19.

[1174] Schedule 10 para 6 FSMA: "A person does not incur any liability under s.90(1) or (4) if he satisfies the court that the person suffering the loss acquired the securities in question with knowledge — (a) that the statement was false or misleading, (b)of the omitted matter, or (c) of the change or new matter, as the case may be."

[1175] See also: HUDSON, *Securities Law*, 578, para. 23-16; HUDSON, *The Law of Finance*, 1061, para. 41-41; *Comp.*: COUSINS and CHARMAN, 'Misrepresentation on bond issues: liability in the secondary market', 19.

[1176] DAVIES, 'Davies review. Discussion paper', p. 17, para. 27.

[1177] DAVIES and WORTHINGTON, *Gower and Davies' Principles*, 932, para. 25-33.

[1178] HUDSON, *Securities Law*, 578, 23-15 – 23-16; DAVIES, *Principles of Modern Company Law*, 25-32; LEYENS and MAGNUS, 'England', (417) 483; Comp.: COUSINS and CHARMAN, 'Misrepresentation on bond issues: liability in the secondary market', 19;

[1179] DAVIES, *Principles of Modern Company Law*, 25-32; COUSINS and CHARMAN, 'Misrepresentation on bond issues: liability in the secondary market', 19; HUDSON, *Securities Law*, 578, para. 23-16; ALCOCK, 'Misinforming the market', 251; LEYENS and MAGNUS, 'England', 483.

[1180] HUDSON, *Securities Law*, 578, 23-16. The UK statutory regime laid down by s.90 FSMA is also deemed to apply on aftermarket purchases made in reliance on the prospectus, even though no clear time span is explicitly provided for in the FSMA. See in this regard: Possfund Custodian Trustee Ltd. and Another v. Diamond and others, 1. W.L.R. 1351, at 1360. See also: HUDSON, *Securities Law*, 24-48; COUSINS and CHARMAN, 'Misrepresentation on bond issues: liability in the secondary market', 18; DAVIES, *Principles of Modern Company Law*, 25-32; ALCOCK, 'Misinforming the market', 249-250; DAVIES and WORTHINGTON, *Gower and Davies' Principles*, 931, para. 25-33.

[1181] Note that in its decision in *Aeilkema* (1931), the Dutch Supreme Court did not found the application of the presumption of causation on considerations regarding effective investor protection, but instead referred to the claimant-investor's reliance on the integrity of the price formation of financial instruments. Since the misleading information in this case had distorted the claimant-investor's assessment of the value of the instrument and had induced him to purchase the securities at matter, reliance (on the correct pricing mechanism) was considered established. HR 11 December 1931, (*Aeilkema Veenkoloniale Bank*), *NJ* 1932, with ann. by P. SCHOLTEN, 157 and 161 in particular. See on this decision and its implications also: B.J. DE JONG, 'Class actions made difficult', *Ondernemingsrecht*, 2007, afl. 14, 514; DE JONG, *Schade door misleiding*, 122; RAVELINGIEN, Privaatrechtelijke handhaving, 375. See also the next chapter: Part III. Chapter II, para. 423.

confirms that as a matter of principle it is left to the claimant to prove his allegations, yet finds that this principle sits uncomfortably with the investor protection aim underlying the Prospectus Directive. More particularly, it is held that to the extent that national (evidential) rules render investor protection measures provided for by EU legislation illusory, Member States violate their duty to ensure the effectiveness of EU law.[1182] Hence, in the light of the investor protection aim endorsed by Prospectus Directive and consistent case law of the ECJ that Member States must "ensure that the directive is fully effective, in accordance with the objective that it pursues", the Dutch Supreme Court deemed the introduction of a presumption no less than necessary.[1183] Note however that the court indicated that with regard to transactions conducted on primary markets, it is presumed that but for the fraud, the investors would not have bought the securities, whereas with regard to secondary market transactions, it is held that but for the fraud, it is presumed that investors would not have entered into the transaction *under the same conditions.*[1184]

Defendants may refute the presumption, for instance by presenting evidence that the investor knew that the prospectus information was incomplete or inaccurate. Yet it is interesting to note that the Supreme Court asserts that the presumption will be more easily refuted in case it concerns experienced, knowledgeable and professional investors as opposed to retail investors with limited experience and knowledge regarding market mechanisms and financial information.[1185] Similar to the findings with regard to the assessment of causation in the context of investment services, the Dutch Supreme Court deems investor sophistication relevant in this context too.

330. Assessment. – Although the Dutch Supreme Court may deem the introduction of a presumption of transaction causation is necessary in the light of the Prospectus Directive, this holding should not be interpreted as if each and every EU Member State is required to apply a causal presumption in prospectus liability claims to comply with its EU obligations. The EU legislator and the ECJ indeed require the Member States to apply their national liability laws in an effective manner to violations of the EU-originated prospectus rules, yet neither EU law, nor the EU courts have prescribed concrete and specific procedural requirements. As underlined in the first part of this thesis, the effective private enforcement of the EU-originated prospectus rules law is binding in result, but the manner to achieve this result is left to the Member States.[1186] To the extent procedural or evidential rules deprive EU law from being effective in the national legal order, it is within the Member States' province to formulate a solution, which may take the form of a causal presumption, though

[1182] HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht* 2010, 21, with ann. by H.M. VLETTER-VAN DORT, r.o. 4.11.1.

[1183] Referring to art. 5 (3) TEU, the ECJ held in *Von Colson and Kamann v. Land Nordrhein-Westfalen* that "although that provision leaves Member States to choose the ways and means of ensuring that the directive is implemented, that freedom does not affect the obligation imposed on all the Member States to which the directive is addressed, to adopt, in their national legal systems, all the measures necessary to ensure that the directive is fully effective, in accordance with the objective that it pursues" (Case 14/83, *Von Colson and Kamann v Land Nordrhein-Westfalen* [1984] ECR 1891, para. 15). See in this regard also: ARONS and PIJLS, 'Prospectus liability in the Netherlands', 480-481; PIJLS and VAN BOOM, 'Handhaving prospectusaansprakelijkheid', 194; BUSCH, 'Het 'civiel effect' van MiFID', 57. See on this topic also *supra*, Part I, Chapter II, para. 86 ff.

[1184] HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht*, 2010, 21, with ann. by H.M. VLETTER-VAN DORT, r.o. 4.11.2. The Dutch literature is confused on the exact meaning this statement and its implications on assessment and scope of the damages. See: DE JONG, 'Liability for Misrepresentation', 264-265; DE JONG, *Schade door misleiding*, 270.

[1185] HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht* 2010, 21, with ann. by H.M. VLETTER-VAN DORT, r.o. 4.11.2.

[1186] *Supra*, para. 92.

alternatives, such as lowered evidential burdens, for instance, may suffice to meet effectiveness requirements too.

2. France: the doctrine of the loss of a chance

331. Unlike Belgium, the UK, the Netherlands and Germany, investors claiming losses pursuant to erroneous prospectus information cannot invoke a causal presumption according to French law. Instead, French courts have increasingly applied the theory of the loss of a chance to solve the difficulties investors encounter in establishing reliance.[1187] In *Gaudriot*, the Cour de Cassation went as far as confirming that the application of the theory of the loss of a chance is the only manner to approach investor suits claiming to have held securities following deficient information.[1188]

3. Concluding remarks

332. Observing that many investors struggled with the requirement of causation, legislators and courts responded to the problems by reversing the burden of proof, with the notable exception of France where the theory of the loss of a chance is applied to facilitate investor claims following erroneous prospectus information. Interestingly, these presumption of causation are confined to the context of prospectus liability and do not apply to breaches of continuous reporting obligations.[1189] As a result, the requirement of reliance in claims following deficient secondary market information is still governed by traditional liability law.[1190] Confronted with very similar problems however, courts have developed other techniques and methods to deal with the matter of transaction causation. In the next section, the reliance requirement is discussed in detail.

C. Transaction causation: secondary market litigation

333. Prior to setting out the actual analysis of reliance, a brief overview of the scope of transactions that may underlie an investor claim for compensation in the context of deficient market disclosures is presented. Especially when liability for continuous reporting is governed by statutory law, limitations may be applied with regard to the scope of transactions covered. These limitations are often related to (evidential problems in the context of) causation coupled with the ubiquitous fear for unlimited liability claims, i.e. the floodgate argument. More particularly, whilst many courts and legislators do

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[1187] (*Flammarion*) CA Paris, 25th Ch., 26 September 2003, Jurisdata 2003-224156, (Soulier e.a./SA Flammarion e.a.), *Bull. Joly Soc.*, 2004, n° 1, 84, with ann. by J.-J. DAIGRE; *Bull. Joly Bourse*, 2004, 43, with ann. by E. DEZEUZE; *JCP-E*, n° 19, Mai, p. 695, with ann. by G. DE VRIES. (*Sidel*) T. corr. Paris, 11e Ch., 12 September 2006, (*Sidel*), *Bull. Joly Soc.*, 2007, §14, 120-136, with ann. by J.-F. BARBIERI. CA Paris 17 October 2008, *Rec. Dalloz*, 2008, 2867. See also: B. GARRIGUES, E. DEZEUZE AND N. RONTCHEVSKY, 'Infractions financières (délits financiers, sanctions administratives et disciplinaires, sanctions civiles)', *RTD Fin.*, 2006, N° 3, 162-173; SCHMIDT, 'Affaire Sidel', 2522; SPITZ, *La réparation*, 204, para. 388; S. SCHILLER, 'L'indemnisation du préjudice de l'actionnaire en cas de diffusion d'une information erronée', *Rev. sociétés*, 2009, no. 8, Août, étude 12, 6; CLERC, 'La réparation du préjudice', 33 para. 10; N. RONTCHEVSKY, 'L'indemnisation du préjudice des actionnaires trompés par de fausses informations', *Bull. Joly Bourse*, 2010, Juillet-Août, §41, 321, para. 16; E. DEZEUZE, 'Affaire Sidel: divers aspects de l'action publique et de l'action civile relatives aux délits d'initiés, de diffusion d'information trompeuse et de présentations de comptes infidèles', *Bull. Joly Bourse*, 2007, n°1, janvier, §4, 61.

[1188] (*Gaudriot*) Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (SA EPF Partners/A.), *JCP-E* 2010, n° 20, Mai, 1483, with ann. by S. SCHILLER. Since the French case law has not clearly distinguished between claims based on misleading prospectus information on the one hand and claims following secondary market information on the other in its approach towards causation, reference is made to the analysis of the French case law further below for more details and discussion.

[1189] The underlying reasons for this different approach are explored and discussed in detail further below, *supra*, para. 371 ff.

[1190] Those Member States that did provide for a statutory regime applicable to liability following erroneous secondary market information generally did not alter the concept of causation, or facilitate its establishment. See Part. I. Chapter III. See *supra* para. 185 ff.

not question that purchases induced by erroneous issuer information result in compensation, the same cannot be said about (1) continue to hold (i.e. abstain from selling) securities following deficient disclosures that were purchased earlier, (2) abstaining from purchasing securities or (3) selling them pursuant to deficient information. Whereas the focus on purchases is rather obvious in the context of prospectus liability rules, it raises questions in the context of secondary market information. More particularly, while investors can only buy or not buy in the primary market, they can buy, not buy, sell and not sell (hold) on the secondary markets.

1. Transactions covered

a. Decisions to purchase or sell v. decisions to hold or not acquire

334. A number of different scenarios may be thought of when considering the potential impact of deficient market disclosures on investment decisions, yet not all these scenarios may allow claimants to file an admissible claim. For instance, overly optimistic forecasts or omissions of potential law suits against the issuer, the loss of important clients etc. may mislead investors and the market and elicit purchases of the issuer's shares or convince an investor to hold (i.e. not sell) the shares. Similarly, overly pessimistic information or omissions or untimely disclosures of positive information may cause an investor to sell or not to purchase the issuer's shares. Examples of investors who decide to sell as a result of deficient information disclosures include examples of untimely disclosed mergers or the untimely disclosures of the resignation of directors or executives.[1191] Examples involving non-acquirers, i.e. investors deciding not to purchase the issuer's shares following omitted or incorrect negative information, on the other hand are rather uncommon, probably because of the hardship to prove such a claim.[1192]

[1191] See for instance the French decision in *Vilgrain*: Cass. Com. 27 February 1996, (Vilgrain/Alary), *LPA* 1996, n° 21, 7-10, with ann. by D. MARTIN. The investor, Alary, requested the chairman of the company (that was not listed) to find a buyer for the shares she had in the company. The president negotiates the purchase of shares with a third party, the company Boeygues, but does not inform the seller, Alary, of his negotiations with Boeygues. Instead, the shares are purchased by the chairman and some companions for 3.000 francs per share, and 50 percent of any amount paid over 3.500 francs in case of repurchase of the shares. Four days later, the chairman and others involved resell the shares for 8.800 to the company Boeygues. The investor files suit for fraud, claiming she would never have sold for 3.000 francs per share to the chairman and the companions, had she known about the deal and price agreed with Boeygues. Another example is the decision in *Geltl* (Germany), which concerned the untimely announcement of the resignation of a CEO. Although the CEO of DaimlerChrysler had decided to resign in April 2005, informed some of the directors and officers of his intention, yet only officially announced his resignation in July 2005. See in this regard: OLG Stuttgart 22 April 2009, *BB* 2009, 1266; *ZIP* 2009, 962; *WM* 2009, 1233; BGH 22 November 2010, *BB* 2011, heft 9, 523, with ann. by A. KOLLMORGEN and F. STEINHARDT; E. VANDENDRIESSCHE, 'De (ruime) interpretatie van het concept 'voorwetenschap' door het Europese Hof van Justitie in het Geltl-arrest', *TBH*, 2013, afl. 3, 179. For other examples: (the Netherlands) Hof Amsterdam, 15 July 2009, LJN BJ2691, *JOR* 2009/325, with ann. by A.C.W. PIJLS (untimely disclosed merger). See on this decision also: G.T.J. HOFF, *Openbaarmaking van koersgevoelige informatie*, Deventer, Kluwer, 2011, 298-299.

[1192] For instance, assume a situation in which rumors about a potential merger started circulating and reached the stadium in which the potential merger is not entirely certain yet, but should nonetheless be announced under the reporting obligations. Yet, suppose that the issuer does not disclose the news on the possible merger, contrary to the ongoing reporting obligations. Suppose that the announcement of the possibility of a merger – even though not entirely certain – would have increased the stock price from €35 to €40 per share in the hypothetical scenario. As the news is not announced however, the price fluctuates around €35-€36 per share instead. Assume that two weeks later, the issuer discloses that a merger has been agreed, that the deal is certain and also announces who the CEO of the merged entity will be, pushing the share price from around €36 to €43 per share. In this scenario, there is a theoretical chance that investors may come forward arguing that they would have purchased securities had they known that a merger may be agreed in the coming days or weeks, when the shares were trading for a hypothetical price of €40 per share. In this scenario, the investors would have seen an increase of €3 per share when the deal was completed. However, as this kind of claims is obviously very hard to prove, this is mostly a hypothetical scenario.

335. In many jurisdictions, the admissibility of a claim depends on the type (non-)transaction that allegedly caused the loss. More particularly, courts or statutes may distinguish between the decision to act upon misinformation on the one hand, being to purchase or sell securities, and not act on the other, being to hold the securities bought earlier (not sell) or not purchase them. This distinction is for instance made in the German legislation relating to liability for deficient ad hoc disclosures (§§ 37b, c WpHG), which limits the circle of eligible plaintiffs to those who acted upon the information to file claim, contrary to those who decided to abstain from trading following the deficient disclosures.[1193] In the UK on the other hand, the regulation applicable to ad hoc (and periodic) disclosures allows investors who acquired, held or disposed of the securities in reliance on false information to file claim.[1194] In several other Member States, no clear statutory provisions on the matter are found, though similar distinctions have been made in the case law rendering claims contending investment decisions to abstain from trading irrecoverable.[1195]

336. The distinction between claims based on effectuated transactions as opposed to decisions to continue to hold securities is partly motivated by pragmatic considerations and partly by the fear for creating a litigation system that would stretch beyond what legislators and courts deem acceptable and might allow claimants with meritless claims to file suit.[1196] Second, allowing holders or non-acquirers to file suit might trigger a surge of claims since every single person who is holding or who did not buy securities following wrongfully pessimistic or omitted positive market disclosures could theoretically come forward and claim compensation. As this might result in an unrestricted and enormous range of licit plaintiffs, such a system may lean heavily on the defendant.[1197] Thirdly, as pointed out in the DAVIES review of the UK issuer liability regime, claims of holders or non-acquirers generally do not

[1193] According to §37b para. 1 (1) and (2) WpHG (covering the wrongful omission or delay of ad hoc disclosures) only those who acquired securities in the period following the omission of insider information and have remained the owners until after a corrective disclosure has been made can file claim, together with those who acquired securities prior to the existence of insider information and who sold after its (unjustly delayed) disclosure. In case of disclosure of erroneous information, covered by §37c para. 1 (1) and (2) WpHG, those investors who purchased after the disclosure and have remained the owners until after a corrective disclosure has been made can file, together with those who purchased the securities before the erroneous information was made public and have sold before the corrective disclosure was made. See also: SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, §§37b, c WpHG, para. 64 ff. Note however the BGH decided otherwise in claims brought for erroneous secondary market information based on the general tort provision of §826 BGB (see further below). This only applies to claims filed according to §§37b, c WpHG. In case the claim is based on § 826 BGB on the other hand, no such limitations are employed. See also SETHE in H.D. ASSMANN and U.H. SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, Köln, Verlag Dr. Otto Schmidt, 2009, §§ 37b, c, para. 13 and para. 53; T.M.J. MÖLLERS and F.C. LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 14; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 110-111; EHRICHE, 'Deutschland', 280-281; MÖLLERS, Organhaftung, 2106, para. 21.

[1194] S.90A FSMA.

[1195] See in this regard the comparative oversight in HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 111-112 and references cited. The limitations with regard to decisions to hold are similar to the doctrine in the US where rule 10b-5 requires "a connection with the purchase or sale of a security". See for instance the US Supreme court decision issued on 13 March 2006 in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 126 S.Ct. 1503; *Blue Chips Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); and *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (C.A.2 1952). The decision in the latter case is generally referred to as the *Birnbaum*-rule (according to which an actual transaction is required in order to claim damages based on rule 10b-5) and was later confirmed by the US Supreme Court in *Blue Chips Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). See also: A.R. PALMITER, *Securities Regulation*, New York, Aspen Publishers, 2008, 359; J.D. COX, R.W. HILLMAN and D.C. LANGEVOORT (eds.), *Securities Regulation. Cases and materials*, New York, Aspen, 2006, 665. See also *infra*, Part III, Chapter II, para. 400.

[1196] Especially in case of collective actions, this might induce opportunistic and frivolous claims to mingle with the meritorious ones at the expense of the court system and defendants. See also: L. TIMMERMAN and M.-L. LENNARTS, 'Niederlande', K.J. HOPT and H.C. VOIGT, *Prospekt- und Kapitalmarktinformationshaftung*, Tübingen, Mohr Siebeck, 2005, 803; see also: R. VEIL, 'Die Haftung des Emittenten für fehlerhafte Information des Kapitalmarkts nach dem geplanten KapInHaG', *BKR* 2005, 95; T.M.J. MÖLLERS and F.C. LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 14.

[1197] See the references cited in the previous footnote.

stand a chance for their claims would be very hard to prove in terms of reliance rendering the inclusion of these claimants more or less meaningless.[1198] Especially claims filed by non-acquirers, alleging that but for the wrongful negative information or omitted positive information they would have purchased securities[1199], would present the courts with intricate problems to assess the loss since courts can by no means find out how many securities the investor would have bought and at what point in time (and thus at what price) he would have bought them. Allowing these claims to be brought would require courts to pass highly arbitrary and hypothetical decisions.[1200]

Only to the extent that evidential facilitations would apply (such as a presumption of reliance) vis-à-vis holders of securities, the inclusion would have an impact and (practical) relevance. In the UK for instance, holders were added to the list of licit plaintiffs in the most recent amendment of s.90A FSMA notwithstanding the negative recommendation in the Davies review.[1201] Since the requirement of reliance is to be strictly applied in this context, however, it does not appear feasible that holders of securities can bring successful claims. Whereas purchasers and sellers, who effectuated a transaction within a relatively short time after misinformation took place, can at least refer to the actual ordering of the transaction as an indication of their investment decision following the information[1202], holders cannot. In combination with a strict requirement of reliance, the inclusion of holders thus indeed appears condemned to remain dead letter in a majority of the cases.[1203]

337. Not all Member States maintain restrictions with regard to holders and non-acquirers however.[1204] French courts for instance appear to have changed course over time. Whereas the first reported decisions on the matter seemed to confirm the irrecoverability of losses following decisions

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[1198] Under s.90A FSMA, governing liability claims for erroneous ad hoc and periodic disclosures reliance is to be established by the investor-claimant. See on this topic also: S. PAPST, 'Germany: Liability for Misstatements', February 2007, available at: http://webarchive.nationalarchives.gov.uk/+/hm-treasury.gov.uk/independent_reviews/davies_review/ 8; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 111; BARTH, *Schadensberechnung*, 156; MÖLLERS, Organhaftung, 2106, para. 22.

[1199] This kind of claims may for instance occur in case rumors about a potential merger are circulating and have reached the stadium in which the potential merger is not entirely certain yet, but should nonetheless be announced under the reporting obligations. If issuers do not disclose the news or even deny the rumors (wrongfully), there is a theoretical chance that investors may come forward arguing that they would have purchased securities had they known that a merger may be agreed in the very near future. As the price may increase at the moment of the rumors already, it may go further up when the merger becomes certain and confirmed. Investors may claim damages in this scenario of the additional price increase that occurred between the first announcement of a potential merger and the later confirmation of the merger. Other examples include for instance the discovery of oil or development of a new product of which the economic value or possibility to exploit or commercialize is uncertain at the moment when the discovery should be announced, but turns out better than expected afterwards. As this kind of claims is obviously very hard to prove, it is mostly considered a theoretical scenario.

[1200] See: P. DAVIES, 'Davies Review of issuer liability: Final Report', 2007, available at: http://www.treasurers.org/node/3258 24; SETHE in ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §§ 37b, c, para. 13.

[1201] It should be noted that not only holders were added to the list of potential plaintiffs, but sellers as well. The former version of s.90A FSMA only provided a forum for purchasers of securities, barring both holders and sellers. Since this exclusion was considered not sensible at all and therefore criticized, sellers were included via the amendment as well. See on this also: DAVIES, 'Davies Review: Final Report', 24.

[1202] The German Supreme Court has accepted transactions within short periods of time after deficient disclosures were made, as worthwhile indications of reliance on the misrepresentation in making investment decisions. See further below, para. 345.

[1203] In (the rather exceptional) case that an investor can present evidence that he consulted the deficient information (for instance electronically), courts may take that into consideration, yet in the majority of the cases investors will encounter difficulties to produce evidence of their claim.

[1204] Some Member States have remained silent on the matter. No relevant case law has been reported with regard to Belgium for instance, nor do the Netherlands seem to have much relevant case law on the matter. Consult for instance: TIMMERMAN and LENNARTS, 'Niederlande', 803. Note however the decision of 15 February 2012, handed down by the Utrecht Court of First Instance. The decision explicitly mentions the possibility of a causal relation between the misleading ad hoc information issued by Fortis Bank and the decision to continue to hold (i.e. not sell) securities and the fact that this may result in compensation if all conditions are met. Rb Utrecht, 15 February 2012, LJN BV3753, (*X./ Ageas N.V., (formerly Fortis N.V.)*), *JOR* 2012/243, r.o. 4.77.

to hold securities[1205], more recent cases held that investors who bought their shares *before* the false accounts were published were entitled to damages.[1206] The court reasoned that investors who had acquired shares *before* the misleading information was issued, were deprived of their right to make a well informed decision to sell the shares before the sharp decrease of the stock price occurred following the discovery of the fraud. A similar decision was issued by the Paris Tribunal de Grand Instance in *Sidel, Sedri* and *Vivendi*, and by the court of appeal of Limoges and the Cour de Cassation in *Gaudriot*.[1207] Likewise, the German Supreme Court held that investors who refrained from selling previously obtained shares as a result of the misrepresentations are equally entitled to redress provided they prove their allegations when the claim is based on § 826 BGB.[1208] In the light of the aforementioned restriction imposed by §§37b, c WpHG, this appears somewhat odd and open to criticism for adding to the overall complexity of the differing liability regimes.[1209]

b. Claims for deficient disclosures of information v. omissions of information

338. A second distinction that can be made with regard to the scope of recoverable transactions concerns claims pursuant to omitted information as opposed to incomplete or inaccurate information. With regard to omissions, claimants can hardly contend to have sold or purchased securities in reliance on omitted information. Reliance in this context should therefore be understood as reliance on the

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[1205] More particularly, in its decision in *Société Générale de Fonderie***,** the tribunal of first instance held that only (1) *acquisitions* of securities, (2) in direct relation with the harmful behavior, (3) in the period in which the deception took place could be considered recoverable. The appellate court and the French Supreme Court confirmed this point of view. In this particular case, the investor-claimant had already purchased shares long before the erroneous disclosure was made, but acquired additional securities after it was made public. In his claim, the investor-claimant therefore asked compensation for the purchases made following the wrongful disclosure and for the securities he had decided to hold on to, also consequently to the disclosure. The irrecoverability was confirmed in a single sentence by the French Supreme Court, which pointed out that "*only those losses that stem from the inflated stock price can be considered certain and the direct result of the infringement*" (*own translation*). The French Supreme Court did not elaborate on the claimant's argumentation that the decision to purchase additional shares on the one hand and the decision to hold se purchased before the stock price got inflated were indivisible. Nor did the court respond to the claimant's argument that the decision to hold the shares constituted the loss of a chance. See for these decisions: TGI Paris, 11e Ch., 20 December 1990, cited in a comment by JEANTIN & A. VIANDIER, Part II Droit Boursier, *RD. Bancaire*, 1991, n° 24, (66) 69-70; CA Paris, 9th Ch., 15 January 1992, (*SG de Fonderie*), JurisData: 1992-020282; *Dr. sociétés*, 1992, §189, with ann. by H. HOVASSE; *RTD com*., 1992, 884, with ann. by P. BOUZAT; and: Cass., crim., 15 March 1993, (*SG de Fonderie*), pourvoi n° 92-82.263, p. 12-13; *Bull. Crim*., 1993, n° 112, 270 ff.

[1206] (*Comptoir des Entrepreneurs)* CA Paris, 9th Ch., 16 December 1998, n° 98/00828 ("[…] les actionnaires dont les droits étaient *antérieurement* acquis, ils sont fondés à soutenir qu'ils ont été privés de l'exercice efficace de leur droit de vote **et** *surtout de la faculté de revendre aussitôt leurs titres avant la chute brutale de leurs cours*;" (emphasis added)). The French Supreme Court partially reformed the appellate decision, though not with regard to the decision to compensate the investors who decided to hold the shares after the erroneous information was made public. Cass., Crim., 29 November 2000, Jurisdata: 2000-008063. Similar: CA Paris, 18 December 1995, (*Landauer*), *Banque & Droit* 1996, n°48, 35, with ann. by H. DE VAUPLANE and F. PELTIER; *JCP-E*, 1996, I, pan., 482. Considering the investor-claimant's demand for damages in recovery for the shares purchased and held as a result of the erroneous information, the court only considered those acquired after the wrongful information was disclosed recoverable.

[1207] (*Sidel*) T. corr. Paris, 11e Ch., 12 September 2006, (*Sidel*), *Bull. Joly Sociétés*, 2007, §14, 120-136, with ann. by J.-F. BARBIERI. See for a comment on the decision also: DEZEUZE, 'Affaire Sidel: divers aspects de l'action publique et de l'action civile relatives aux délits d'initiés, de diffusion d'information trompeuse et de présentations de comptes infidèles', §4, 37-62; SCHMIDT, 'Affaire Sidel', 2522-2523. CA Paris 17 October 2008, *Rec. Dalloz*, 2008, 2867. (*Sedri*) TGI, Paris, 11th Ch., 27 February 1998, *Bull. Joly Soc.*, 1998, n°9, §291, 925 ff., with ann. by N. RONTCHEVSKY (especially para. 6 of the comment). See also: SPITZ, *La réparation*, 275, para. 437. (*Gaudriot***)** Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (SA EPF Partners/A.), *JCP E* 2010, n° 20, Mai, 1483, with ann. by S. SCHILLER; partially published in *RTDF* 2010, nr. 2, 60, with ann. by N. SPITZ. (*Vivendi*) TGI Paris, Corr., 11th Ch., 21 January 2011, *RTDF* 2011, nr., 102, with ann. by N. RONTCHEVSKY; *Bull. Joly Bourse* 2011, April 2011, 236, with ann. by J.L. CAPDEVILLE; *Bull. Joly Soc.* 2011, March, 211, with ann. by J.-.F. BARBIERI. See also: RAVELINGIEN, Privaatrechtelijke handhaving, 355, para. 685.

[1208] BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1274 (EM.TV). As already pointed out earlier investors encounter serious difficulty in presenting proof in this regard. See also BARTH, *Schadensberechnung*, 156.

[1209] For instance: A. HELLGARDT and J. KOWALEWSKI, 'Der Stand der Rechtsprechung zur deliktsrechtlichen Haftung für vorsätzlich falsche Ad-hoc-Mitteilungen', heft 34 *DB* 2005, 1842.

adequate provision of information by the issuers, implying that in case certain material information is wrongfully concealed, investors can claim they would have acted differently had the information been disclosed. In the US, the hardship for claimants to establish proof of having relied on omitted information resulted in the introduction of a rebuttable presumption of reliance in the US Supreme Court decision *Affiliated Ute Citizens of Utah v United States*.[1210] Though similar presumptions are mostly absent in the EU, claims based on the wrongful omission of issuer disclosure are broadly accepted and mentioned in the statutory and case law.[1211]

2. Assessment of transaction causation: criteria

339. Similar to the problems discussed in the context of investment services, investors who seek to remedy losses allegedly suffered as a result of wrongful continuous disclosures encounter significant difficulties to demonstrate that but for the wrongful information, a different investment decision would have been made. From a comparative perspective, different techniques and approaches have been developed and employed to interpret and apply transaction causation in this regard. Some courts have focused on evidential difficulties, whereas others sought to identify appropriate criteria to assess reliance in an attempt to streamline and objectify their assessments. A different approach is applied mostly, yet not exclusively, by French courts that, again, resort to the doctrine of the loss of a chance. The different approaches to the causal relation between deficient issuer disclosure and the losses claimed are discussed in detail below.

a. Circumstantial evidence

340. However rare, there may be circumstances supporting the investor's contention that he indeed relied on the erroneous information. Notable examples of are for instance the French appellate decision in *Eurodirect Marketing* ('Eurodirect').[1212] *Eurodirect* concerned an ad hoc statement presenting overly optimistic expectations on future earnings. The investor-claimant in this case purchased shares long before the issuance of the misleading statement[1213] but increased his participation after the announcement was made, and particularly after he personally contacted Eurodirect with the request to send him the necessary documents to verify the information

[1210] Affiliated Ute Citizens of Utah v United States, 406 U.S. 128 (1972).

[1211] None of the prospectus liability regimes or the rules regarding secondary market information liability excludes this type of claims. Reference can for instance be made to s.90A FSMA in which claims pursuant to the dishonest omission of information are explicitly mentioned. A similar note goes for Germany: whereas §37c covers for wrongful ad hoc statements, §37b applies to wrongfully omitted ad hoc disclosures. In those Member States where no specific regimes are enacted, no indications of limitations of this kind were found in the reported case law.

[1212] CA Colmar, 14 October 2003, n° 1 A 01/03432 X c/SA Eurodirect Marketing, *Bull. Joly Bourse* 2004, §89, 467-472, with ann. G. DOLIDON, *Bull. Joly Bourse* 2004, §89, 472-477. It should be noted that the court in First Instance considered causation established, though only compensated half of the damages claimed by the investor, holding that each investment include a certain degree of uncertainty, which justifies the reduction of the damages awarded; see: TGI Strasbourg, 8 June 2001, cited in G. DOLIDON, 'La diffusion d'informations prévisionelles inexactes, fait générateur de responsabilité civile des émetteurs', in a comment by the decision of the Colmar Court of Appeal, CA Colmar, 14 October 2003, n° 1 A 01/03432 X c/SA Eurodirect Marketing, *Bull. Joly Bourse* 2004, §89, 473 ff.; see also: C. ARSOUZE and P. LEDOUX, 'L'indemnisation des victimes d'infractions boursières', *Bull. Joly Bourse*, 2006, Juillet-Août, §101, (399) 419; MAGNIER, 'Information boursière et préjudice des investisseurs', 560. See on this decision also: ARONS, *Cross-border Enforcement*, 130-131; CLERMONTEL, *Le droit de la communication financière*, 382, para. 567.

[1213] The claimant bought shares already as early as September 1997 (115 shares), October 1997 (100 shares), January 1998 (20 shares), February 1998 (131 shares), March 1998 (123 shares). The shares bought in October 1997 were shares from BSA, a related company. All the other shares concerned Eurodirect Marketing shares. These data can be found in the appellate decision issued by the Court of Appeal of Colmar: CA Colmar, 14 October 2003, n° 1 A 01/03432 X c/SA Eurodirect Marketing, *Bull. Joly Bourse* 2004, §89, 467-472, with ann. by G. DOLIDON, *Bull. Joly Bourse* 2004, §89, 472-477.

communicated to the public in the April statement. In the light of these circumstances, the court found that the decision to purchase additional shares and the decision to retain shares that were bought earlier were directly related to the misstatements.[1214] The fact that the investor did not sell all his shares after he discovered the delusion and continued holding some of the Eurodirect shares did not affect the court's analysis as the court considered it plausible that the investor retained some of his trust in the defendant, even after he became aware of the deception. The court also points out that the investor seeks to remedy the loss incurred following the sale of shares in September shortly after he realized that he had been deceived, but no claims were made with regard to the shares he retained after the truth was revealed. The French Supreme Court explicitly confirmed the appellate decision, including the appellate court's analysis of causation.[1215] Cases in which case-specific elements or circumstances offer sufficient support for an investor's contention that he relied on the misstatements are however fairly exceptional.[1216] In the majority of the cases, courts will have to dig deeper and use more creativity to determine whether or not the claimants can be assumed to have relied on the erroneous information.

b. *Investor profile and sophistication*

341. Similar to the findings in the context of financial services, investor classification may also prove relevant with regard to the assessment of transaction causation in issuer liability claims. This may appear somewhat odd at first sight since suitability (or appropriateness) assessments and the like are imposed on financial service providers in the distribution process but do not apply in the context of drafting and disclosing issuer information. Individual investor characteristics nevertheless do have relevance in assessing whether or not reliance on the misleading information had an impact on the

[1214] The court refuted the argument of the defendants that the claimant sold a significant part of his shares as early as September 1998, although the company rectified the earlier report no sooner than October 1998. The defendants particularly argued that the fact that the claimant sold his shares before the deception was publicly revealed, demonstrated the investor's lack of reliance on financial information. The court however disagreed by pointing out that the claimant was not inexperienced as investor and, as such, that he recognized the situation already as alarming before any formal statement was communicated to the market. He was particularly alarmed by the stock price that had started to fall gradually since a month and the announcement on the replacements to take place in the board of directors. Moreover, not only the claimant became alarmed by the course of events and reacted by selling part of his shares, so did the market, the court noticed (« […] un signal d'alarme suffisamment éloquent, qui ne remet pas en cause le fait qu'il ait pu être trompé par les informations diffusées en avril de la même année. Le marché a d'ailleurs réagi dans le même sens ».). CA Colmar, 14 October 2003, n° 1 A 01/03432 X c/SA Eurodirect Marketing, *Bull. Joly Bourse* 2004, §89, 471.

[1215] « la Cour d'appel a pu décider qu'il existait un lien de causalité entre les manquements commis par la société et le préjudice subi […] en revendant à perte les actions qu'il n'aurait pas achetées s'il n'avait pas été victime d'informations trompeuses »; the review of the causal analysis of the French Supreme Court can be consulted in the second part of the decision: Cass. 22 November 2005, *Banque et Droit*, 2006, 35; *RTD com* 2006, 445. The Supreme Court furthermore considered that the appellate decision was well founded since it is, as a matter of law, not incorrect to derive causation from the actual facts of the case. The court specifically refers to (1) the regular and significantly larger purchases made by the investor-claimant in the three month period after the erroneous information was disclosed made by the investor-claimant; and (2) to the fact that the investor-claimant took the effort of contacting the board of directors with respect to the disclosure after the general meeting to verify the information at matter. See: Cass. 22 November 2005, *Banque et Droit*, 2006, 35; *RTD com* 2006, 445.

[1216] A second example of case-specific circumstances indicating and supporting that the investors indeed read and relied the misleading information at matter is the Belgian court decision relating to the takeover of *Bank Nagelmaker*. The suit was brought by investors speculating on information in a two-year-old prospectus issued to launch to a takeover bid. When the investors learned that the information in the prospectus had deceived them, they filed claim and were awarded damages in court. Kh. Brussel 16 April 1996, *R.P.S.* 1996, 431-443, annoted by B. FERRON; see also: DIEUX, 'Examen de jurisprudence', 257; K. VANDERHEYDEN, *Openbare aanbiedingen*, 305 ff. The decision was reversed in appeal however, for the appellate court held that the defendants could not be considered liable for reliance on the prospectus that had been issued to potential investors two years earlier. (Brussel, 25 June 2002, Rép. 2002/4154, referred to in X. DIEUX, "Examen de jurisprudence", *R.C.J.B.* 2004, 257) Notwithstanding its rejection in appeal however, the case shows that case-specific facts may be sufficient to convince a court of the causal connection between deficient information and investment decisions.

investment decision, as is demonstrated in the case law. Courts have occasionally distinguished between relatively aggressive, speculative investor profiles on the one hand, and prudent or diligent investors, i.e. investors with conservative profiles, on the other hand to assess whether the investors were likely to have relied on misrepresentations.[1217] Investors who could present evidence or indications suggesting that they had been exclusively interested in conservative, safe investments were earmarked as prudent investors whereas the others were classified as investors with a (more) speculative profile.[1218] The assessment of the type of investor was generally based on indications such as the composition of the (whole) investment portfolio, the strategies applied to manage the portfolio and the like.[1219] Investors were therefore asked to submit relevant material and evidence – such as overviews of all investment portfolios currently and formerly held by the investors– to enable the court to classify the claimants as speculative or prudent. In case an investor-claimant was subsequently found to be prudent, meaning that he was seeking a conservative investment, the court accepted that the investor had relied on the misrepresentation.[1220] In case the court identified rather aggressive or speculative profiles and strategies, it was deduced that an investor was willing to take considerable risks and was, as such, indifferent to information (mis)stating the risk.[1221] It could therefore be

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[1217] See for instance the Belgian court decision in *Barrack Mines* initiated by aggrieved investor against the lead manager for disseminating erroneous information about the issuing company, an Australian mining Company (Barrack Mines), inducing investors to subscribe to the offering. In first instance, the court divided the group investors into two groups to assess whether they had relied on the misstatements, being prudent or diligent investors on the one hand and more speculative investors on the other hand. Kh. Brussel 17 October 2003, *DAOR* 2004, 87, with ann. by S. DELAEY, "Barrack Mines: Prospectusaansprakelijkheid van de kredietinstelling". The decision was reformed in appeal however: Brussel 3 October 2006, *DAOR* 2007, 227-238, with ann. by: S. DELAEY; S. DELAEY, "Barrack Mines: het vervolg". See also extensively on these court decisions: VANDENDRIESSCHE, 'Fraud-on-the-market', para. 53 ff. A similar approach was employed in another Belgian court decision, this time against a Canadian insurance company that had offered euro bonds on the Belgian and Luxembourg markets. In less than a year after the offering however Confederation Life became insolvent and was liquidated. Since the bonds were subordinated, the investors failed to recover their investment and therefore decided to sue the syndicate of banks for recovery of their loss. The claims brought against Confederation Life were centered on the violation of precontractual information obligations because the investor-claimants had not been informed on the subordinated character of the bonds, and the fact that the rating they had received was incorrect. To assess whether or not the investor-claimants had relied on the misrepresented rating and/or whether the subordinated nature of the bonds would have had any affect on the investement decision had the investor known about it, the courts divided the group investors into two groups being prudent or diligent investors on the one hand and more speculative investors on the other hand. See in this regard: Kh. Brussel, 26 March 1997, *Bank. Fin.* 1997, iss. 5, 334-340. With regard to the numerous decisions relating to Confederation Life, see also: Kh. Brussel, 10 February 2000, T.R.V. 2000, 100-104, with ann. by J. TYTECA; Brussel 8 March 2002, *Bank. Fin*. 2002, iss. 4, 234-237, with ann. by F. DE BAUW & M. DUPLAT, 'Emission d'euro-obligations et devoir de due diligence du banquier chef de file. Observations à propos de l'arrêt de Confederation Life', *Bank.Fin.* 2003, iss. 2-3, 136-144; Kh. Ghent, 13 February 2001, *TBH* 2001 (quoted by M. DELMEE) 631-633; Kh. Charleroi, 1 March 2001, not published, R.G. A/98/00347, aangehaald door M. DELMEE, "Bank-Financieel Recht. Euro-obligaties, foutieve informatie – gebrek aan informatie – verplichting van de koper – (niet) aansprakelijkheid van de bank", *TBH* 2001, 633; Kh. Luxemburg, 12 December 1997, *TRV* 2000, 105-109, with ann. by J. TYTECA; *TBH* 1998, with ann. by J.-P. BUYLE, 126-127.

[1218] The Confederation Life court held in this regard for instance that the investors who had subscribed to the bonds following advice provided by their bank or who could prove they had been incorrectly informed on the rating, could be considered of the prudent type.

[1219] Kh. Brussel 17 October 2003, *DAOR* 2004, 87, with ann. by S. DELAEY.

[1220] Idem.

[1221] Note however with regard to Confederation Life, the claims were based on two different legal bases, being contractual and precontractual liability. The claimants who purchased the bonds directly from the leading banks were able to bring a contractual claim aimed at the annulment of their subscription. The claimants to whom the bonds were distributed via other banks as intermediaries lacked a contractual relation with the leading banks, causing them to bring a tortious claim against the leading banks based on the violation of the precontractual information obligation. Deciding on the nullity claim, the court granted the claim only with regard to the so-called prudent investors. The speculative investors were not left empty-handed however. Their claim based on tortious liability (art. 1382 BCC) and aimed at compensatory damages was granted since the court found that as a result of misinforming the client-investors on the rating, the investors were unable to assess the risks correctly. A clarification for the different reasoning regarding the impact of the wrong information on the investment decision in the context of the nullity-claim on the one hand and in the context of the tortious claim on the other hand is lacking. A possible explanation may be the difference in remedies that apply depending on the foundation of the claim, particularly the annulment of a transaction versus compensation. Annulment of the purchase of the securities is a far more difficult and burdensome solution to the problem than damages, since securities transactions are difficult to reverse, especially if further assumed that the latter type of investors did not rely on the information and would most likely have invested the way they did regardless of the incorrect information.

342. The distinction between prudent, conservative investors and speculative or risk seeking investors as a decisive element in the assessment of transaction causation immediately raises considerable objections, however. First of all, this approach seems to lead to the objectionable and unjust implication that speculative investors are not entitled to correct and complete information, while prudent investors are. Second, the fact that an investor is willing to take risk or even speculate does not imply that he is willing to accept any investment, regardless of the risk attached to it and the price to be paid for the effect. It is commonly understood in finance theory that investment decisions are generally based on a tradeoff between risk and (expected) return, which implies that securities or investments bearing higher risks generally require a higher expected return in order to be appealing for (rational) investors.[1222] When deciding to invest, investors – including those with speculative interests – balance the expected return of investments or securities against the risks and may decide to purchase (or not) depending on whether the risk is adequately compensated by a higher expected return.[1223] To the extent the information on the investment and the risks is wrong, incomplete or misleading, investors are mislead on the risk and expected return regardless of their profile and risk appetite. Thirdly, risk seeking or speculative investors may also be looking for investments with low risks, for instance to balance their portfolio or hedge risks taken with other investments. Hence, the idea that investors with higher risk profiles are willing to take on investments regardless of the risks involved is wrong and entirely inconsistent with the basics of finance.[1224]

343. In addition to the substantial objections set out in the preceding paragraph, the practical implications of the approach based on investor (risk) profile and sophistication should also be taken into account. A first problem in this regard is the determination of the criteria that will be used to single out speculative, aggressive or risk seeking investors. It was noted in one of the previous chapters already that these assessments depend on a range of criteria weighed by courts on a case by case basis. Furthermore, the precise underlying motivation(s) that caused an individual investor to make a certain investment decision are very difficult to assess and render the assessment highly subjective in nature. Moreover, in a majority of the cases, an investor's decision was most likely influenced by multiple elements, rather than only one piece of information.[1225] Second, besides the fact that the assessment is highly subjective, this method also brings about a tremendous workload for courts. Taking into account that prospectus liability and other issuer disclosure liability cases often involve large numbers of investor-claimants, the feasibility of courts subjecting the contentions, portfolios and investment strategies of each single investor to a meticulous review in order to determine the profile of the investor can be put to serious doubt.

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trading on a secondary market took place. A similar remark was made with reference to the Dutch Supreme Court decision in the securities leasing liability case filed against financial intermediaries. See: PIJLS, 'Schade effectenlease-overeenkomsten deels vergoed', 257. *Contra*: WEHRMEIJER, 'Verdere duidelijkheid over afwikkeling van effectenleaseovereenkomsten: de wijze waarop Hof Amsterdam omgaat met de richtinggevende oordelen van de Hoge Raad', 2. See also: VANDENDRIESSCHE, 'Fraud-on-the-market', para. 53 ff.

[1222] J. HULL, *Risk management and financial institutions*, Hoboken, Wiley, 2012, 2; N.G. MANKIW and M.P. TAYLOR, *Economics*, London, Thomson learning, 2006, 551; C.P. JONES, *Investments: Analysis and Management*, Hoboken, John Wiley & Sons, 2010, 11.

[1223] Idem.

[1224] Similar: VANDENDRIESSCHE, 'Fraud-on-the-market', para. 66.

[1225] See also: J.E. FISCH, 'The Trouble with Basic: Price Distortion after Halliburton', 90 *Wash. University Law Review*, 2013, 902.

344. A final observation relates to the analogy with the role of investor profile and sophistication in the context of courts' assessment of transaction causation in the context of financial services, such as financial advice and portfolio management. As was the case with regard to the assessment of transaction causation in the context of defective investment services, courts assess transaction causation in the context of deficient disclosures also in the light of investor sophistication. Analogous to the finding in the context of financial services, the less sophisticated the investor, the more leniency displayed by the courts. Even though it may well be that unsophisticated investors are more easily misled, either by financial service providers or directly by misleading or inaccurate market disclosures, it should be noted that the situations are nonetheless not identical. More particularly, to the extent that financial instruments bear more risk than disclosed in the available information to the investor public, investors purchasing those securities to which the deficient information relates, are exposed to risks for which they may not be compensated in terms of an increased return.[1226] Market disclosures impact the price of the securities to which the information relates and therefore deludes the entire investor public, regardless of whether it concerns prudent or speculative, sophisticated or unsophisticated investors, as is extensively discussed in the next chapter.[1227] At this point, we suffice with the conclusion that different from violations of information obligations in the context of financial services, deficient market disclosures (or omissions) may affect the price of the securities to which the misleading or omitted information relates and cause investors to suffer losses regardless of their sophistication or risk profile.[1228] Despite these objections, however, investor profiles are nonetheless still employed as an indicator to assess reliance in claims following misleading capital market information. A telling example in this regard is the *World Online* decision by Dutch Supreme Court in which it was held that transaction causation is presumed, provided no evidence of the contrary is presented. Interestingly, the court held that vis-à-vis professional investors the presumption is more likely to be refuted since these investors are less likely to rely on misrepresentations and instead trust their experience and understanding of the market mechanisms.[1229]

c. *Time-related criteria*

345. While German courts responded to the difficulties investors encountered in establishing reliance in the context of prospectus liability with the development of the *Anlagestimmung*-theory (which eventually culminated in the enactment of a statutory presumption of causation), no similar doctrine was developed with regard to continuous reporting obligations. Courts have consistently and repeatedly limited the *Anlagestimmung*-theory to prospectus liability claims[1230] and adhered to a rather

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[1226] See also *supra*, 139. VANDENDRIESSCHE, 'Fraud-on-the-market', para. 66. The relation between securities prices and financial information is also elaborated further below in the context of the efficient capital market hypothesis (see *infra* para 396 ff).

[1227] See *infra*, para. 393 ff. and the references cited, including D. FISCHEL, 'Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities', 38 *Bus. Law.*, 1982, 1; GILSON and KRAAKMAN, 'The mechanisms of market efficiency', 549; GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 711.

[1228] Idem.

[1229] HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht*, 2010, 21, with ann. by H.M. VLETTER-VAN DORT, r.o. 4.11.2.

[1230] See for instance BGH, 13 December 2011, XI ZR 51/10, (IKB), *BB* 2012, 530 with ann. by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537-538; BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560; BGH, 4 June 2007, II ZR 173/5 (ComROAD V) para. 13 ff.; BGH, 19 July 2004, II ZR 217/03 (Infomatec), at p. 21-22; *NJW* 2004, 2668; (all decisions cited are also available at: http://www.bundesgerichtshof.de). See also: OLG Frankfurt/Main, 17 March 2005, n° 1 U 149/04, *BB* 2005, iss. 31, 1648; See in the same sense: HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 138; BARTH, *Schadensberechnung*, 166 ff.; HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 207. See also *infra*: para. 373.

stringent approach towards transaction causation (‘*haftungsbegründende Kausalität’*) in the context of investor claims pursuant to erroneous ad hoc or periodic information.[1231] With regard to the criteria used to assess reliance, the German Supreme Court notably held that the interval of time between the disclosure and the disputed transactions is strongly indicative.[1232]

346. In a stream of cases concerning fraudulent ad hoc statements that took place on the ‘*Neuer Markt*’, a segment of the traditional German exchange market (Deutsche Börse) specialized in the so-called new economy and inspired on the US NASDAQ, investors claimed recovery for losses allegedly suffered due to misstatements from the issuers involved in the large scale fraud.[1233] Even though it concerned vastly fraudulent information in some of these cases, many investors failed to obtain compensation for they could not meet the requirement of (transaction) causation.[1234] In the case of *ComROAD* for instance, the then chairman (“*Vorstandsvorsitzenden*”) SCHNABEL was held responsible for over forty reports disclosed to the market, all of them containing false information regarding the company’s performance and customer figures.[1235] The stock price, which had initially amounted to €20.50 per share at the issuance in 1999 and rose (with fluctuations) up to €64 per share in 2000, sank to below €50 at the beginning of 2001 and gradually further down to €20 in April 2001. After the news got out that only 1.4 percent of the €93.6 million in revenues had actually been realized, the shares sank below €1 per share.

The court held that the ad hoc statements were highly fraudulent and intently deceiving meeting the standard of intention set by §826 BGB.[1236] Notwithstanding the undisputable fraudulent behavior of the defendants however, claimants are required to deliver proof of the fact that it was due to the fraudulent information that they engaged in their purchases of ComROAD shares. Whereas the Court of Appeal had facilitated the proof of this requirement by considering that the causal connection had

[1231] The underlying motivations to distinguish between primary and secondary market information obligations are discussed in detail below (see *infra*, para. 371 ff.). The rather strict or even rigid approach is also noted in L. KLÖHN, 'Die Haftung wegen fehlerhafter Ad-hoc-Publizität gem. §§ 37b, 37c WpHG nach dem IKB-Urteil des BGH', *AG*, 2012, heft 10, 351 and the references cited in ftn. 80. It is noted that following the IKB-decision in December 2011, a significant evolution has taken place with regard to the assessment of causation in claims grounded on §§37b, c WpHG (ad hoc information). This evolution is extensively discussed further below. The approach to transaction causation described under this heading remains relevant however, since the change took place with regard to claims filed according to §§37b, c WpHG.

[1232] BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560; II ZR 173/5 (ComROAD V); BGH 7 January 2008, II ZR 229/05 (ComROAD VI), paras 2-3; II ZR 86/06 (ComROAD VII), paras 2-3; BGH 3 March 2008, II ZR 310/06 (ComROAD VIII), paras 2-3; BGH 26 June 2006, II ZR 153/05 (ComROAD) and II ZR 206/05; BGH 19 July 2004, II ZR 217/03, 218/03 and 402/02, (Infomatec), *WM* 2004, 1721; BGH 9 May 2005, II ZR 287/02, *ZIP* 2005 (EM.TV). these decisions can also be consulted at: http://www.bundesgerichtshof.de. See also: MÜLLER-MICHAELS, ‘BGH verschärft Haftung', 537-538; HELLGARDT and KOWALEWSKI, 'Stand der Rechtsprechung', 1839; KLÖHN, 'Die Haftung wegen fehlerhafter Ad-hoc-Publizität', 351.

[1233] The cases referred to concern the scandals and decision in Infomatec, ComROAD and EM.TV as cited in the previous footnote. For an overview of the *Neuer Markt* scandals and subsequent collapse: RICHTER, *Schadenszurechnung*, 3-5; B. WITTKOWSKI, 'Die Entwicklung am Kapitalmarkt, insbesondere am Neuen Markt', *ZHR*, 2003, 167, 130. See also: FERRAN, *Building an EU securities market*, 245.

[1234] The investors based their claims on §826 BGB since §37b, c WpHG had not yet been enacted. Moreover, it was due to these scandals that the regulation introducing §§37b, c WpHG was enacted in the first place. See *supra*, ftn. 696.

[1235] The chairman, who was sentenced to jail for a number of years, went as far as adding imaginary companies to its customer base. See also: BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560; II ZR 173/5 (ComROAD V) paras 2-3; BGH 7 January 2008, II ZR 229/05 (ComROAD VI), paras 2-3; II ZR 86/06 (ComROAD VII); BGH 3 March 2008, IIZR 310/06 (ComROAD VIII); BGH 3 March 2008, II ZR 310/06 (ComROAD VIII); BGH 26 June 2006, II ZR 153/05 (ComROAD) and II ZR 206/05. See on these cases also: A. CAHN and D.C. DONALD, *Comparative Company Law*, Cambridge, New York, Cambridge University Press, 2010, 534-540.

[1236] BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560; II ZR 173/5 (ComROAD V); BGH 7 January 2008, II ZR 229/05 (ComROAD VI), II ZR 86/06 (ComROAD VII); BGH 3 March 2008, II ZR 310/06 (ComROAD VIII); BGH 3 March 2008, II ZR 310/06 (ComROAD VIII); BGH 26 June 2006, II ZR 153/05 (ComROAD) and II ZR 206/05.

been indirectly established in the sense that it was assumed that the investors had relied on the integrity of the information and, by consequence, the correctness of the stock prices, the Bundesgerichtshof (BGH) rejected this point of view. Instead, the BGH demanded concrete and individual proof of reliance on the information by each and every investor-claimant.[1237]

Confronted with the question on how this evidence could be established, the Bundesgerichtshof indicated that the causal connection between the disclosures and the investment decision could be derived from the length of the period of time between the announcements and the transactions.[1238] More particularly, considering the circumstantial facts of the case, the BGH considered that since the investor-claimant had purchased the securities shortly after the disclosure was made (i.e. the same day), the short lapse of time might be a decisive indication of reliance in combination with the party's declaration stating that the investment decision was made in reliance on the misrepresentation.[1239]

347. Secondly, as already explained, the BGH rejected the general and direct application of the theory of '*Anlagestimmung'* in the context of secondary market transactions yet stated that '*Anlagestimmung'* might exceptionally apply in individual cases when sufficiently supported by the evidence presented.[1240] In the case at hand however the BGH considered that a period of nine or six months between the announcement of the erroneous information and the transaction at matter was too long to consider a causal connection based on *Anlagestimmung* between the two events plausible.[1241] In another decision, the BGH considered the fact that a part of the shares were purchased within hours or within a few days after the misrepresentations had been made as an indication that a causal connection might exist.[1242] Along the same lines, the BGH also accepted causation in a case where investors had purchased stocks two months after the erroneous ad hoc announcement had been made.[1243] In a case brought before the München *Landesgericht*, the court took into account – amongst other elements – that the investor-claimant had purchased the securities five weeks after the alleged

[1237] See for instance: BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560, at para. 16; BGH 9 May 2005, II ZR 287/02, *ZIP* 2005 (EM.TV), p. 16-17; BGH 7 January 2008, II ZR 229/05 (ComROAD VI), para. 24.

[1238] BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560 at para. 22; BGH 19 July 2004, II ZR 218/03 (Infomatec), at p. 12-13. See also: MÖLLERS, Organhaftung, 2106, para. 20.

[1239] BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV). The declaration of the party may have evidential value based on §448 ZPO. See also: BARTH, *Schadensberechnung*, 155; T.M.J. MÖLLERS, 'Das Verhältnis der Haftung wegen sittenwidriger Schädigung zum gesellschaftsrechtlichen Kapitalerhaltungsgrundsatz - EM.TV und Comroad', *BB* 2005, iss. 31, 1642; MÖLLERS, Organhaftung, 2106, para. 21; RICHTER, *Schadenszurechnung*, 89; MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§37b, c WpHG, para. 334.

[1240] BGH 19 July 2004, II ZR 217/03, 218/03 (Infomatec), *WM* 2004, 1721; *NJW* 2004, 2668; (the decisions cited are also available at: http://www.bundesgerichtshof.de). See also: MÖLLERS, Organhaftung, 2105, para. 19; LEUSCHNER, 'Kausalitätserfordernis unrichtigen Ad-hoc-Mitteilungen', 1050.

[1241] BGH 19 July 2004, II ZR 218/03 (Infomatec), at p. 12-13. See also: TEICHMANN, 'Haftung für fehlerhafte Informationen am Kapitalmarkt', 956.

[1242] BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560 at para. 22; BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV). In the latter case, the BGH particularly points out that with regard to the case at hand, in which the investor-claimant had purchased the securities shortly after the disclosure was made (i.e. the same day), the fact that the purchase had taken place very shortly after the disclosure, the short lapse of time might be a decisive indication of reliance in combination with the party's declaration. This could be considered evidence in the context of §448 ZPO.

[1243] BGH 19 July 2004, II ZR 402/02 (Infomatec), confirming the lower courts' finding that the causal link between erroneous ad hoc information and the investment decision at matter had been sufficiently established. LG Augsburg, 24 September 2001, *BB* 2001, heft 47, 2130; *DB* 2001, 2334; OLG München, 1 October 2002, *ZIP* 2002, 1989, with ann. by T.M.J. MÖLLERS and F.C. LEISCH; see also on these decisions: TEICHMANN, 'Haftung für fehlerhafte Informationen am Kapitalmarkt', 956; CASPER, 'Significance of the Law of Tort', 98.

erroneous market disclosure.[1244] Considered along with the other facts of the case, the court did not deem it probable that the disclosure had induced the investor to make the purchase.

348. A similar reasoning regarding the lapse of time between investment decisions and the disputed disclosures in assessing reliance was made in the French *Flammarion* decision.[1245] Other than the German courts however, the French courts have mostly resorted to the doctrine of the loss of a chance to deal – in a rather indulgent manner – with the difficulties surrounding the assessment of causation and damages for deficient issuer disclosure.

d. The doctrine of the loss of a chance

349. The doctrine of loss of a chance can be considered a typical French solution to the problem of the establishment of reliance in liability claims following erroneous issuer disclosures, although its appeal has extended beyond France and is applied in various other jurisdictions as well. Over time, French courts have adopted the doctrine as the standard approach to solve issuer liability matters, as demonstrated in *Flammarion*[1246], *Gaudriot*[1247] and *Sidel.*[1248] *Gaudriot* marks a final stage of this evolution for it was decided by the French Supreme Court that the loss of a chance is the only correct manner to deal with the problem of uncertain reliance.[1249] The advantage of this solution is that on the one hand, the establishment of (uncertain) transaction causation is facilitated, if not entirely solved from an investor's point of view, whereas the issuer is only liable for the loss of a chance and thus has to compensate for only a part of the claimed damages. The aforementioned cases have however also shown that the doctrine of the loss of a chance is used as a patch-up allowing courts to avoid complex questions involving causal uncertainty in the context of issuer disclosure. Secondly, the flexible application of the loss of a chance-doctrine has also created the perception that investors are very easily compensated, although only for a limited part of the loss they claim to have suffered. Although this could be defended as an effective compensation system and an effective dissuasion for issuers to be careful with information disclosed to the public from an investor protection point of view[1250], it also enhances litigation and has been criticized for compensating frivolous and meritorious claims alike.[1251]

[1244] LG München, 28 June 2001, *ZIP* 2001, heft 41, 1814, 1817 in particular.

[1245] "[…] la publication du 12 octobre 2000 était de nature à inciter X à prendre immédiatement ses bénéfices sur les actions Flammarion […] sans attendre une remontée future du titre ». CA Paris, 25th Ch., 26 September 2003, Jurisdata 2003-224156, (Soulier e.a./SA Flammarion e.a.), *Bull. Joly Soc.*, 2004, n° 1, 84, with ann. by J.-J. DAIGRE; *Bull. Joly Bourse*, 2004, 43, with ann. by E. DEZEUZE; *JCP-E* n° 19, Mai, p. 695, with ann. by G. DE VRIES.

[1246] (*Flammarion*) CA Paris, 25th Ch., 26 September 2003, Jurisdata 2003-224156, (Soulier e.a./SA Flammarion e.a.), *Bull. Joly Soc.*, 2004, n° 1, 84, with ann. by J.-J. DAIGRE; *Bull. Joly Bourse*, 2004, 43, with ann. by E. DEZEUZE; *JCP-E* n° 19, Mai, p. 695, with ann. by G. DE VRIES.

[1247] (*Gaudriot*) Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (SA EPF Partners/A.), *JCP-E 2010*, n° 20, Mai, 1483, with ann. by S. SCHILLER; partially published in *RTDF* 2010, nr. 2, 60, with ann. by N. SPITZ; CA Limoges, 6 October 2008, RG 07/00286. See also: S. XERRI, 'La mise en cause des dirigeants et leur assurance de responsabilité', *RGDA*, 2009, n° 2(662) 666; TGI Guéret, 20 February 2007, *Banque & Droit*, 2007, n° 113, mai-juin, 45-47.

[1248] (*Sidel*) T. corr. Paris, 11e Ch., 12 September 2006, (*Sidel*), *Bull. Joly Sociétés*, 2007, §14, 120-136, ann. by J.-F. BARBIERI. See also: GARRIGUES, DEZEUZE AND RONTCHEVSKY, 'Infractions financières', 162-173. Confirmed in CA Paris 17 October 2008, *Rec. Dalloz*, 2008, 2867.

[1249] Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (*SA EPF Partners/A.*), *JCP-E* 2010, n° 20, Mai, 1483, with ann. by S. SCHILLER.

[1250] SCHILLER, 'L'indemnisation du préjudice de l'actionnaire', 6-10; S. SCHILLER, 'Nature des fautes susceptibles d'engager la responsabilité des dirigeants à l'égard des actionnaires et méthode d'évaluation de préjudice subi', *JCP-E*, 2010, n° 20, mai, 1483 (comment on Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (*SA EPF Partners/A.*)).

[1251] See for a critical opinion: MARTIN, 'La réparation du préjudice des investisseurs', 1777 ff.; SCHMIDT, 'Affaire Sidel',; and: CLERC, 'La réparation du préjudice', 37, noting that the theory of a loss of a chance can be considered questionable

The assessment of the probability of the lost chance – necessary to calculate the damages – remains highly uncertain which opens the door to arbitrariness according to several commentators.[1252]

II. The concept of recoverable loss in the traditional investor autonomy-based approach

350. It was demonstrated in the previous section that the prospectus liability regimes enacted or designed by the courts imply a requirement of reliance, holding that an investor must have relied on the misinformation to make an investment decision. To ease the evidential burden, most Member States have introduced statutory or judicial presumptions, reversing the burden of proof with regard to reliance. Hence, investors are assumed to have purchased securities as a result of the impact the misinformation on their decision and are entitled to be restored in the situation as if the securities would not have been purchased. Again, the difficulties lay with the determination of the alternative scenario, yet in some instances, the remedy has been anchored in statutory provisions that do not leave room for discussion. This section sets out with the concept and measurement of the loss in the context of prospectus liability.

A. Concept and measurement of the loss: prospectus liability

1. Calculation of damages: Rescissory measure

a. Germany: Rescission ("Rückabwicklung") under §21 WpPG – prospectus liability[1253]

351. Whereas most Member States left the determination of the remedy to the courts, the German legislator fixed the loss an investor can claim following misleading prospectus information in §21 WpPG.[1254] According to §21 WpPG an aggrieved investor is entitled to return the shares in exchange for the price paid to acquire them. In case the investor already sold the shares, the compensation is fixed at the difference between the purchase price and the price received upon the sale.[1255] The statutory regime laid down in §21 WpPG also applies with regard to aftermarket sales, to the extent they took place within two years since the first listing of the issued shares. The purchaser of 'old' shares during those two years after new shares from the same issuer were offered, can also invoke §21 WpPG provided that the old shares cannot be distinguished from new shares.[1256] The measure of damages applied in prospectus liability claims according to §21 WpPG can hence be considered a

('*contestable'*); SPITZ, *La réparation*, 325-326. See in this regard also: RAVELINGIEN, Privaatrechtelijke handhaving, para. 687-688; and ARONS, *Cross-border Enforcement*, 136; BUSCH and SILVERENTAND, 'The Netherlands', 234, para. 7.144.

[1252] Idem.

[1253] The same principles govern prospectus liability according to §§ 13, 13a VerkProspG and § 127 InvG. See also: WAGNER, 'Schadensberechnung', 497.

[1254] Note that in the US as well the measure of damages in the context of s.11 and s.12 Securities Exchange Act 1933 has been fixed. See for a more extensive discussion, *infra* ftn. 1300.

[1255] See also: WAGNER, 'Schadensberechnung', 497; ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 218 ff.; MAIER-REIMER/PASCHOS in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §28, para. 10 ff.; SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, 414, §44-§45; GROSS, *Kapitalmarktrecht*, §44; HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 13 ff.

[1256] PAPST, 'Germany', 6. See more extensively: H. KLÜHS, 'Die Börsenprospekthaftung für "alte" Stücke gemäß §44 Abs. 1 S. 3 BörsG', *BKR* 2008, heft 4, 154-156; C. GERNER-BEUERLE, *Die Haftung von Emissionskonsortien*, Berlin, De Gruyter, 2009 217-218.

simple rescissory measure, according to which damages are to be awarded equal to the price paid for the securities and their price after the misrepresentations have been disclosed to the market.

b. Belgium and the Netherlands: concept of loss and remedy in the case law

352. Although not embedded in statutory provisions as in Germany, Belgian and Dutch courts seem to measure investor losses in the context of prospectus liability along the same lines.[1257] In the few reported Belgian court decisions concerning prospectus liability, the investors were granted damages equal to the initial investment amount, added with interest and lowered with the residual value of the securities at the date of the judgment or with the price received from the sale.[1258] The most recent Dutch decision on prospectus liability on the other hand introduced a presumption of transaction causation, yet does not assess the damages to which the investors are entitled. In line with the assumption that investors would not have invested in the securities but for the misrepresentations, however, it seems logical that investors are entitled to damages for the total investment loss incurred as a result of their decision to subscribe to the offer. Or put differently, it may be expected that the damages should be based on the initial purchase price paid less the value of the sale of the securities or the price after the misrepresentations were revealed. As investors settled the case following the Supreme Court's landmark decision in World Online, no definitive court decision has been passed with regard to the damages. Considering the damages for which the case got settled however – being the purchase price paid for the shares, plus interest from 10 percent to 15 percent –it is clear that the parties involved took the initial investment value as a reference to fix the damages.

353. Yet in the Dutch literature it has been repeatedly held that loss unrelated to the deficient information but instead due to general market circumstances is not recoverable.[1259] Underlying this criticism is the principle that investors should bear risks, and losses stemming from those risks, inherent to investment themselves. This idea however sits uneasy with the rescissory principle, which holds that investors should be restored to the position they were in before they entered into the transaction.[1260] Under the rescissory measure, investors recover the total injury suffered in order to erase all losses suffered because of an erroneous investment decision that they were induced to make following misrepresentations. The rescissory measure also offers courts a very easy and straightforward method to award damages, relieved from complications related to contemporaneous and intervening factors that affected the securities price, yet are unrelated to the misrepresentation as such.

[1257] Note that even though a statutory regime was enacted in Belgium, no provisions have been embedded to arrange the damages investors are entitled to as is the case in Germany. As a result, the concept of loss in the context of prospectus liability is the general concept deployed with regard to art. 1382 BCC.

[1258] See more extensively: VANDENDRIESSCHE, 'Fraud-on-the-market', para. 69.

[1259] JANSEN, SCHREUDER and VERHAGEN (eds.), *Prospectusaansprakelijkheid*, 88; ARONS and PIJLS, 'Prospectus liability in the Netherlands', 479; DE JONG, *Schade door misleiding*, 303.

[1260] The assumption that another investment decision would have been taken but for the misrepresentation underlies the concept of reliance in investor litigation and thus leads more or less automatically to rescissory damages as a result.

2. UK: Out of the pocket loss: common law tort measure

In the UK, prospectus liability claims are governed by s.90 FSMA.[1261] Since the statutory rules do not deal with the measure of damages to be awarded if an investor's claim is successful, the matter is left to the courts and has been characterized by uncertainty and dissonant opinions in the literature. Although there is consensus that the damages should be based on the common law of tort, it is yet unclear whether and under which circumstances the measure of fraud or deceit or the measure of negligence is to be applied.[1262] As confirmed by the House of Lords decision in *Smith New Court Securities*, the deceit measure is considerably more favorable to investor-claimants as factors such as foreseeability, remoteness and the SAAMCO-doctrine are disregarded and damages under the rescissory measure are awarded.[1263] In *Smith New Court Securities* for instance, the claimant was awarded damages recovering for the whole of the difference between the purchase and the sale price, notwithstanding the fact that much of that loss had been caused by an unrelated fraud. The prevailing view however adopts the negligence measure since the statutory tort of s.90 FSMA leans closer to the tort of negligence.[1264] Under the negligence measure of recoverable losses, only those losses directly caused by the misrepresentation are recoverable.[1265] In the context of prospectus liability, this has been interpreted by several commentators as implying that recoverable losses under s.90 FSMA are limited to the difference between the price that has been paid for the securities and the price that would have been paid absent the wrong.[1266] Put differently, the mispricing loss is the applicable standard of loss, according to this point of view.

3. France: loss of a chance

354. Concept of loss. – Even though French courts have adopted various approaches towards causation in misrepresentation cases over time, the most recent decision issued by the highest French

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[1261] In case a claim is successfully filed based on the common law tort of negligence, deceit, damages are award according to the standard of negligence or deceit respectively. These measures of damages were discussed earlier (see *supra* para. 116, 117 and 149-154).

[1262] No authoritative case law has been reported on the matter so far, but as as many shareholders suffered considerable losses during the financial crisis of 2008-2009, some litigation may arise in the near future. It may be worth mentioning that with regard to prospectus liability, a claim is being prepared against Royal Bank of Scotland pursuant to an allegedly misleading prospectus in 2008 that portrayed a rights issue as an attempt to improve ratios, while it later turned out that the bank was recommended to shore up its balance sheet by the UK supervisor, then the FSA, in order to remedy the critical situation that emerged following the acquisition of ABN Amro. The bank allegedly failed to disclose capital ratios and a loan (£12 bn) it had taken on provided by the US Federal Reserve. Shareholders subscribed to the offer for 200p per share, whereas the shares plummeted to 30p per share within a few months. In April 2013, 12.000 small investors and 100 large investors signed up to a group action lodged by RBoS Shareholders Action Group against former RBS directors and the bank itself on their behalf (representing losses around £4 billion in total). See in this regard: S. BAIN, 'Shareholders have year to take action against RBS', *Herald (Scotland)*, April 6, 2013; 'Investors launch £4bn compensation claim against RBS', *BBC News Scotland*, 3 April 2013; 'Investors sue Royal Bank of Scotland and former directors, *The Guardian*, 3 April 2013. See in this regard also: HUDSON, *Securities Law*, 583, 23-23; ALCOCK, 'Misinforming the market', 251; ARONS, *Cross-border Enforcement*, 208-209. According to HUMPHERY-JENNER, a very limited amount of derivative suits concerning secondary market transactions following false statements have been filed (M. HUMPHERY-JENNER, 'Securities Fraud Compensation: A Legislative Scheme Drawing on China, the US and the UK', 38 *Legal Issues of Econ Integration*, 2011, no. 2, 147 and references cited, 149.

[1263] Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254. A minority in the UK literature seems to deem the fraudulent measure of damages appropriate: HUDSON, *Securities Law*, 642, para. 24-81 ff.

[1264] ALCOCK, 'Misinforming the market', 251; F. GORE-BROWNE, *Gore-Browne on companies*, vol. 2, Bristol, Jordans, loose-leaf section chapter 43, [4].

[1265] For a more extensive discussion of loss according to the measure of negligence, see *supra*, para. 116, 117 and 149-154.

[1266] HUDSON, *Securities Law*, 642, para. 24-81; ALCOCK, 'Misinforming the market', 251; GORE-BROWNE, *Gore-Browne on companies*, section chapter 43, [4]; DAVIES and WORTHINGTON, *Gower and Davies' Principles*, 931, para. 25-31, in conjunction with ftn. 141.

court held that losses claimed for deficient market disclosures principally consists of the loss of a chance either to invest in better alternatives or to sell the securities and avoid suffering future losses.[1267] This approach is employed to award compensation to investors who acquired securities pursuant to the wrongful information but also to those who acquired the securities *before* wrongful information was disseminated and allegedly held the securities – instead of selling them before the truth was known and before the price fell – as a result of the misrepresentations.[1268] By marking the loss of a chance as the only recoverable loss in this kind of cases, the French Supreme Court expressly rejects the approach taken by the appellate court that held that the rescissory measure must be applied, resulting in investors being compensated for the total investment.[1269] The decision seems to discard the application of various approaches to damages and causation in investor litigation cases in the French courts and marks the loss of a chance as a standardized and uniform concept of recoverable loss henceforth.[1270]

355. Measurement of the loss. – As already indicated with regard to investment services, the doctrine of the loss of a chance eliminates the difficulties related to uncertain causation yet creates other ones with regard to the assessment of damages. More particularly, to value the lost chance, the probability of the claimant making another investment decision must be multiplied with the result that would have been obtained.[1271] Both parameters are however unknown and uncertain in most cases, which then results in courts' best guesses, as has been repeatedly illustrated by the lack of reasoning and calculation supporting or clarifying the amount of damages awarded in court. In *Sidel* for instance, each and every investor-claimant was awarded a lump sum compensation of €10 per share, whereas in *Regina Rubens* the compensation amounted to about 10 percent of the loss suffered.[1272] In *Sidel* the court explained that only part of the claimed loss was recoverable since investment activities are inherently speculative and investor should not be compensated for the materialization of those risks.[1273] Only those losses directly related to the wrongful actions withheld are recoverable. The court then concludes that following this reasoning, damages of €10 per share are apportioned. In a similar case, the Paris Tribunal de Grand Instance also awarded damages for an amount of €10 per share in

[1267] (*Gaudriot*) Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (SA EPF Partners/A.), *JCP-E 2010*, n° 20, Mai, 1483, with ann. by S. SCHILLER; partially published in *RTDF* 2010, nr. 2, 60, with ann. by N. SPITZ; CA Limoges, 6 October 2008, RG 07/00286. See also: XERRI, 'La mise en cause des dirigeants et leur assurance de responsabilité', 666; TGI Guéret, 20 February 2007, *Banque & Droit*, 2007, n° 113, mai-juin, 45-47.

[1268] (*Comptoir des Entrepreneurs*) CA Paris, 9th Ch., 16 December 1998, n° 98/00828; confirmed: Cass., Crim., 29 November 2000, Jurisdata: 2000-008063; (*Sedri*) TGI, Paris, 11th Ch., 27 February 1998, *Bull. Joly Soc.*, 1998, n°9, §291, 925 ff., with ann. by N. RONTCHEVSKY; (*Gaudriot*) Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (SA EPF Partners/A.), *JCP-E 2010*, n° 20, Mai, 1483, with ann. by S. SCHILLER; partially published in *RTDF* 2010, nr. 2, 60, with ann. by N. SPITZ. (*Vivendi*) TGI Paris, Corr., 11th Ch., 21 January 2011, *RTDF* 2011, 102, with ann. by N. RONTCHEVSKY; *Bull. Joly Bourse*, April 2011, 236, with ann. by J.L. CAPDEVILLE; *Bull. Joly Soc.* 2011, March, 211, with ann. by J.-F. BARBIERI. See also: RAVELINGIEN, Privaatrechtelijke handhaving, 355, para. 685.

[1269] CA Limoges, 6 October 2008, RG 07/00286. See also: XERRI, 'La mise en cause des dirigeants et leur assurance de responsabilité', 666.

[1270] MARTIN, 'La réparation du préjudice des investisseurs', 1777; N. RONTCHEVSKY in a comment on TGI Paris, Corr., 11th Ch., 21 January 2011, *RTDF* 2011, nr., (102) 103; J.-F. BARBIERI in a comment on the same decision in *Bull. Joly Soc.* 2011, March, 214.

[1271] SPITZ, *La réparation*, para. 381-282 and ftn. 81, 240-241, para. 388.

[1272] (*Sidel)* CA Paris 17 October 2008, *Rec. Dalloz*, 2008, 2867 and T. corr. Paris, 11e Ch., 12 September 2006, (*Sidel*), *Bull. Joly Sociétés*, 2007, §14, 120-136, with ann. by J.-F. BARBIERI. (*Regina Rubens)* Corr. Paris, 11th Ch., 22 January 2007, n° 0106896039, *RTDF*, n° 2, 2007, 123, with ann. by B. GARRIGUES; the decision was confirmed on this point in appeal: CA Paris, 9th Ch., 14 September 2007, *RTDF*, n° 4, 2007, 145.

[1273] See the references cited *supra*, in ftn. 554.

more or less identical wordings as the *Sidel* decision.[1274] Awarding lump sums to recover for investor losses is a recurrent practice in French courts[1275], and has both been criticized and applauded in the literature. The criticism has been directed against the convenient indulging of lump sum compensations at the expense of consistent and well-reasoned decisions and a looming danger of arbitrariness.[1276] Others have however praised and defendant this approach stressing its flexibility and simplicity, especially in comparison with technical, complex and expensive expert reports that may trigger lengthy debates and procedures, while the loss of a chance-approach is also suited to deal with large scale investor litigation in efficient manner.[1277]

B. Concept and measurement of the loss: secondary market liability

356. In France and the Netherlands, courts have not clearly distinguished between liability for misleading information following erroneous prospectuses on the one hand, and the violation of the rules on continuing disclosures on the other. This presumably also goes for the Belgian courts though no reported case law is available to confirm. In other jurisdictions such as the UK and Germany however courts or literature have suggested and applied different approaches with regard to the recoverable loss following wrongful continuing disclosures.

1. The concept of loss according to s.90A FSMA (UK)

357. Common law tort measure of damages. – Analogous to s.90 FSMA, s.90A FSMA lies down the standard for liability for erroneous secondary market disclosures but does not contain provisions on the applicable concept of loss. Again, the common law tort standard is applicable to apportion the damages as the section has been closely modeled on common law tort, leaving the choice between the more generous fraudulent measure of damages on the one hand, and the negligence measure on the other hand, implying that foreseeability and potentially the SAAMCO-doctrine.[1278]

358. Fraud measure – rescissory damages. – Contrary to damages for misleading prospectuses and listing particulars regulated in s.90 FSMA, the prevailing opinion with regard to secondary market disclosures seems to be that the fraudulent measure is better suited given the fact that the statutory tort has conspicuously been modeled to the tort of fraud.[1279] From this perspective, claimants are entitled to recover the difference between what has been paid and what has been received following the

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[1274] (*Vivendi*) TGI Paris, Corr., 11th Ch., 21 January 2011, *RTDF* 2011, nr. , 102, with ann. by N. RONTCHEVSKY; *Bull. Joly Bourse*, April 2011, 236, with ann. by J.L. CAPDEVILLE; *Bull. Joly Soc.* 2011, March, 211, with ann. by J.-.F. BARBIERI.

[1275] Besides *Sidel* and *Vivendi*, see for instance also *Landauer*: TGI Paris, 10 June 1994, *PA* 1994, n°146; confirmed in appeal: CA Paris, 18 December 1995, *Banque & Droit* 1996, n°48, 35, with ann. by H. DE VAUPLANE & F. PELTIER; *JCP-E*, 1996, I, pan., 482. Considering the compensation claim of one of the investor-claimants, the court awarded damages for a lump sum of 5000 ff, whereas the investor-claimant purchased the shares for 3.638 ff.

[1276] D. MARTIN, 'Affaire Marionnaud ou l'usage cosmétique de la perte de chance en matière boursière', *JCP-E*, 2013, no. 22, 1315; CLERC, 'La réparation du préjudice', 33 (also contending that the loss of a chance-doctrine should be applied residually p.36); MARTIN, 'La réparation du préjudice des investisseurs', 1777.; SPITZ, *La réparation*, para. 381-282 and ftn. 81, 240-241, para. 388; similar: BARBIERI in a comment on: T. corr. Paris, 11e Ch., 12 September 2006, (*Sidel*), *Bull. Joly Soc.* 2007, §14, 120-136; and confirmed: CA Paris 17 October 2008, *Rec. Dalloz*, 2008, 2867. The alternative approach suggested by several of these commentators is elaborated on further below.

[1277] S. SCHILLER, 'L'indemnisation du préjudice de l'actionnaire en cas de diffusion d'une information erronée', *Rev. Sociétés*, 2009, no. 8, Août, étude 12, no. 17; RONTCHEVSKY, 'L'indemnisation du préjudice des actionnaires trompés par de fausses informations', §41, 318.

[1278] The difference between the measure of damages in negligence and the measure applied in fraud was discussed in Part I, Chapter III, para. para. 116, 117 and 149-154..

[1279] DAVIES, 'Davies review. Discussion paper', para. 107; DAVIES, 'Davies Review: Final Report', para. 60.

transaction one was induced to enter into as a result of the fraud.[1280] In case of a share purchase, this generally implies that the claimant is entitled to the purchase price less the actual value of the shares when allotted (date of the transaction-rule).[1281] In *Smith New Court Securities* however, the House of Lords ruled that the date of the resale better suited to measure the loss. Although the court notes that the traditional date of the transaction-rule has the manifest advantage of avoiding (complex) questions of causation, departing from this general principle must be possible in order to award adequate compensation to the plaintiff.[1282] The court particularly considers this departure appropriate in case "the open market at the transaction date was a false market, in the sense that the price was inflated because of a misrepresentation made to the market, generally by the defendant".[1283] In these circumstances the court considers that the market value is not decisive, necessitating the court to ascertain the true value as it would have been absent the wrong at the transaction date instead. In line with these considerations, the court consequently assessed the damages in this case as the difference between the purchase price and the price effectively realized on the resale of the shares. In cases of fraud – and presumably statutory torts brought according to s.90A FSMA – damages are hence assessed according to the rescissory measure, which may be considered a relatively generous treatment, as DAVIES points out.[1284] Whether the decision in *Smith New Court* is exemplary for future decisions and whether it preludes a general departure from the rule that the transaction date counts as the reference date remains to be seen.[1285]

2. The German rescissory measure ('*Vertragabschlußschaden'*) v. mispricing losses ('*Kursdifferenzschaden'*)

359. The prevalence of rescissory damages ('*Naturalrestitution'*). – Similar to Belgium and France, German courts initially did not distinguish between primary and secondary market liability to assess losses. Over time, a statutory prospectus regime has been introduced which sets out a comprehensive arrangement, including a causal presumption and recovery measure one is entitled to.

[1280] "The complaint of the plaintiff is that he has been induced by a suppression in the prospectus, to which the statute attaches the character of fraud, to take shares in an undertaking, which, but for this suppression, he would not have joined, and which has turned out to be worthless. […]His grievance is not that he has paid too high a price, but that he has been induced to take shares which, but for the fraud, he would not have taken at all. He is, therefore, in the position of a person who has been induced to take shares and pay the price of them by a fraudulent misrepresentation, and he is, therefore, entitled to recover such damages as have resulted to him from taking such shares. If this damage extends to the entire price paid for the shares he is entitled to recover it", Twycross v. Grant, (1877) 2 C.P.D. 469 CA, at 543. See also: McConnell v. Wright, (1903) 1 Ch. 564 CA; Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254.

[1281] As it was formulated in Waddell v. Blockey, 4 Q.B.D. 67, "[t]he assessment of damages as at that date is usually necessary in order to exclude loss caused by extraneous or coincidental factors"; cited in Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254, at 259. See also: Maple Leaf Macro Volatility Master Fund Anor v. Rouvroy Anor, (2009) EWHC 257 (Comm.); Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254. See also with regard to the application of the fraud measure on share purchases: MCGREGOR, *McGregor on damages*, 1669, 41-003; CARTWRIGHT, *Misrepresentation, mistake and non-disclosure*, para. 5-37 and 5-38; The measurement of the damages through the date of the transaction-rule has been instituted to avoid the claimant being compensated for changes in the value of the property or goods that are unrelated to the misrepresentation. See also: HUBBARD, 'Damages for breach of contract: the correct time for assessing loss', 5.

[1282] See in the same sense: HUBBARD, 'Damages for breach of contract: the correct time for assessing loss', 5; CARTWRIGHT, *Misrepresentation, mistake and non-disclosure,* para. 5-37.

[1283] Idem, at 261. See also Maple Leaf Macro Volatility Master Fund Anor v. Rouvroy Anor, (2009) EWHC 257 (Comm.).

[1284] DAVIES, 'Davies review. Discussion paper', para. 107. See on the concept and measurement of losses in the context of secondary market transactions (s.90A FSMA) also: FERRAN, 'US-style investor suits', 325-326.

[1285] See in this regard also *Parabola* Investments Ltd v *Browallia* Cal Ltd., (2009) EWHC 901 (Comm), which refers and applies the rules set out in *Smith New Court,* and was confirmed in appeal: *Parabola* Investments Ltd v *Browallia* Cal Ltd., (2010) EWCA Civ 486. See on the applicable reference date and the *Smith New Court* decision also FERRAN, 'US-style investor suits', 325-326 and the references cited, particularly in ftn. 59.

This arrangement does not include liability for ongoing disclosures however, which is regulated by §37b, c WpHG with regard to ad hoc disclosure and the general civil liability rules with regard to periodic disclosure. Although liability pursuant to erroneous ad hoc reporting is regulated by specific statutory provisions, these provisions do not contain indications as regards the damages. As a result, the general civil liability rules according to §249 BGB apply, which implies that investors are entitled to return the shares in exchange for the price paid to acquire them ('*Naturalrestitution*').[1286] In its EM.TV decision for instance, the BGH held the managerial board liable (according to §826 BGB) for the intentional dissemination of wrongful information and found that the information had induced investors to acquire the shares. The judgment obliged the defendants to take back the shares and reimburse the purchase price paid by the deceived investors.[1287] In case the investor already sold the shares, the compensation is fixed at the difference between the purchase price and the price received upon the sale.

360. This line of case law has been criticized in the literature for various reasons. First, the BGH has repeatedly held that no alleviations with regard to the burden of proof resting on the investors-claimants can be allowed. Because full proof of a causal connection between wrongful disclosures and investment decisions is difficult and often a threshold too high to meet for investors, few claims succeed. Secondly, the application of the rescissory measure is invariably based on the distortion of the decision process of investors, in the sense that in absence of the wrong the transaction would not have been effectuated and the loss would not have been suffered. Because this implies that investors must be restored in their position as it was without the investment decision, this implies that they recover their total investment, including market losses due to external factors, e.g. a general market decline due to macro-economic factors unrelated to the issuer and the misrepresentations. As a result, general investment risks that should principally be borne by the investor are shifted to the wrongdoer.[1288] Not only commentators resisted the application of the traditional remedy of rescission

[1286] The obligation to take shares back from investors when found liable may however be problematic in case the defendant is the issuer and it concerns vast amounts of shares from the perspective of capital maintenance rules (§§57 ff. AktG) and restrictions to acquire own shares (§71 AktG). The BGH has resolved the conflict holding that capital market liability, aimed at protecting all investors (regardless of whether they are shareholders when filing claim) prevails on the shareholder protective rule lied down in §57 AktG. See in this regard particularly: VEIL (ed.), *European capital markets law*, 301, para. 117; WAGNER, 'Schadensberechnung', 504; HELLGARDT, *Kapitalmarktdeliktsrecht*, 401; MAIER-REIMER/SEULEN in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 14.

[1287] BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV)). For similar cases in which the rescission measure was confirmed: (BGH 19 July 2004, II ZR 402/02, *WM* 2004, 1721 (Infomatec); OLG München, 28 April 2005, (ComROAD III, *ZIP* 2005, 1141-1144; OLG München, 20 April 2005, (ComROAD IV), *BB* 2005, heft 31, 1651-1652; *ZIP* 2005, heft 20, 90; OLG Frankfurt a. M., 17 March 2005, *BB* 2005, 1648. Until recently, it was disputed in the literature whether the rescission measure could also apply with regard to §§37b, c WpHG – applicable to erroneous ad hoc disclosures only. The IKB-decision of the BHG issued on 13 December 2011 put an end to the discussion, holding that both concepts of damages may apply under §§37 b, c WpHG provided the respective requirements with regard to causation are met. BGH, 13 December 2011, XI ZR 51/10, (IKB), available at: http://juris.bundesgerichtshof.de; see also: *BB* 2012, 530 with ann. by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537-538. See in this regard also: HELLGARDT, 'Praxis- und Grundsatzprobleme', 677.

[1288] See in this regard: BAUMS, 'Haftung Falschinformation', 142. See also: MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 266; F. HANNICH, 'Quo vadis, Kapitalmarktinformationshaftung? Folgt aufgrund des IKB-Urteils nun doch die Implementierung des KapInHaG?', *WM* 2013, heft 10, 453; SETHE in ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §§ 37b, c, para. 78; VEIL (ed.), *European capital markets law*, 301; EHRICKE, 'Deutschland', 295; WAGNER, 'Schadensberechnung', 512 ff.; RICHTER, *Schadenszurechnung*, 112. *Contra:* Rejecting this argument as valid: EHRICKE, 'Deutschland', 295, asserting that once it has been established that the loss emerged because of the wrongful information, the recoverable loss should be assessed by comparing the situation before and after the occurrence of the misconduct, implying that each and every loss suffered in that lapse of time is recoverable. Whether the loss suffered because of the price depreciation that occurred during that time was caused directly by the misrepresentations or not is irrelevant since all loss stemming from the investment decision must be recovered. The fact that general market risks are shifted to the wrongdoer is the logical consequence. Taken into account that liability based on §§37b, c WpHG requires misconduct carried out with either gross negligence or intent, the wrongdoer should not be protected from injury resulting from general market risks. The BGH rejected this argument as well: BGH, 13 December in this context, BAUMS noted that courts seemed uncomfortable to apply this remedy to investor losses in the context of secondary market information too.[1289]

361. Hypothetical alternative investment. – Several solutions have been advanced aimed at mitigating this risk shifting issue as a result of applying the rescissory measure. One line of thinking suggests that defendants are allowed to present evidence that the investor would have made another investment decision in absence of the misrepresentation, yet that in this scenario, (part of) the loss would equally have been suffered.[1290] Proponents of this approach have founded their point of view on the principle that losses and benefits generated by one and the same wrongful act must be offset against each other in order to assess the scope of the injury ('*Vorteilsgleichung*').[1291] There is however no consensus on this reasoning in courts or literature[1292], while MÖLLERS and LEISCH rightly indicate that it will often prove very difficult to present evidence with regard to which alternative investment would have been chosen but for the wrong, especially if it concerns retail investors who only trade occasionally.[1293]

362. Assessment. – Whereas the recoverable loss in the context of investment services was argued to depend on the alternative investment the investor would have chosen in absence of the wrong[1294], a similar reasoning seems harder to apply in the context of issuer liability.[1295] Although it may well be that an investor would have invested in other securities, he might also have waited for another opportunity and/or just left the money on a savings account.[1296] Whilst the context of investment services the investment objectives and profile are usually drawn up *ex ante*, claims based on deficient

2011, XI ZR 51/10, (IKB), available at: http://juris.bundesgerichtshof.de; see also: *BB* 2012, 530 with ann. by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537.

1289 BAUMS, 'Haftung Falschinformation', 142, references to the case are cited in ftn. 15 and include OLG München, 1 October 2002, *ZIP* 2002, 1989, with ann. by T.M.J. MÖLLERS and F.C. LEISCH; OLG München, 18 July 2002, *AG* 2003, heft 2, 105-106; LG Bonn, 15 May 2001, *AG* 2001, 484, 486 in particular.

1290 MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 280 ff; SETHE in ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §§ 37b, c, para. 78 ff.

1291 This reasoning particularly holds that the loss suffered pursuant to wrongful disclosures that induced investors to effectuate certain transactions must be matched with the loss they avoided by not making the decision they would have made but for the misrepresentations. Put differently, the losses that have been avoided because of the wrongful disclosures should be considered benefits and hence deducted from the compensation. See in this regard also: RICHTER, *Schadenszurechnung*, 100.

1292 See for instance: EHRICKE, 'Deutschland', 295 (rejecting the argument concerning the shifting of risks to be borne by the investor as invalid in principle, as explained in one of the previous footnotes). Rejecting this solution as well, yet suggesting another approach to limit compensation to the loss directly related to the misrepresentation and excluding loss suffered due to external market factors: WAGNER, 'Schadensberechnung', 519 ff.

1293 For a detailed discussion of this line of thinking and its reception in the courts and literature: MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, 2033, para. 281 ff.; with regard to the aforementioned difficulties in establishing proof of alternative investments: para. 290. The authors also assert that these difficulties do not exist in the same proportion when it concerns professional investors (para. 291). See also: G. SPINDLER, 'Haftung für fehlerhafte und unterlassene Kapitalmarktinformationen – ein (weiterer) Meilenstein', *NZG* 2012, 578. In LG München, 28 June 2001, *ZIP* 2001, heft 41, 1814 and 1817 in particular, the court mentions various elements to conclude that it has been insufficiently proven that the investor suffered a recoverable loss, including the uncertainty as to what alternative investment would have been made with the money.

1294 *Supra*, Part II, Chapter II, para. 267 ff.

1295 In the Dutch literature ARONS and PIJLS also noted the difficulties in this regard: ARONS and PIJLS, 'Prospectus liability in the Netherlands', 479-480; B.J. DE JONG, Aansprakelijkheid, B. BIERENS, C.M. GRUNDMANN-VAN DE KROL, D.J.R. LEMSTRA and T.M. STEVENS, *Handboek Beursgang*, Deventer, Kluwer, 2011, 579. Note also that the German case law has generally rejected the assessment of the hypothetical alternative investment with regard to the assessment of investment losses. See on the topic: MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 280 ff.; GEIBEL, *Der Kapitalanlegerschaden*, 441-444. See on this topic also: BARTH, *Schadensberechnung*, 249.

1296 DE JONG, *Schade door misleiding*, 147.

issuer disclosure require a court to determine the investor's profile *ex post*.[1297] Additionally, whereas expert advice and model portfolios may provide objective and verifiable references as to the composition of an investment portfolio corresponding to a particular investor profile, no similar standards can provide indications to the court as to which particular single investment the investor-claimant would have made absent the wrong. The determination of plausible alternative investments in this context has accordingly been rejected by courts in various jurisdictions as being too speculative and susceptible to arbitrariness,[1298] whilst its feasibility in large scale investor litigation is also questionable. It is hence not surprising that the rescissory measure of damages is more frequently applied by courts and resorted to by legislators to rule out uncertainty and arbitrary assessments. Yet, this approach implies that the loss incurred as a result of general market tendencies is also recovered by investors, even though these risks should principally be borne by the latter.[1299]

363. '**Modified rescissory damages' –** A solution to the criticism may be found by correcting investor compensation based on the rescissory measure by deducting that (part of) the price decline that is proven to be unrelated to the misrepresentation, and therefore unrecoverable. In this regard, reference can be made to the US prospectus liability rules governing investor compensation pursuant to misleading registration statements and misleading prospectuses.[1300] The US regulation provides for a quite complex arrangement with regard to the measurement of the damages, but essentially holds that investors are entitled to compensation based on the rescissory measure, yet if the defendant proves that (part of) the price decline is unrelated to the misrepresentation however, (that part of) the loss is unrecoverable.[1301] This approach requires direct causation between the misleading statements or omissions and does not offer recovery for losses suffered because of other reasons, such as general market circumstances. Alternatively, in those legal systems where the normative element of causation requires that the wrongful act is an adequate, unforeseeable or proximate cause of the loss, such as the UK for instance, this result is also achieved by excluding compensation for losses that are foreseeable and only the indirect cause of loss.[1302] Yet, finding that this approach does not entirely fits the principle according to which investors should be restored to the position they were in had they not

[1297] Similar: ARONS and PIJLS, 'Prospectus liability in the Netherlands', 479-480.

[1298] (Germany) OLG München, 28 April 2005, *ZIP* 2005, 1143 ("Der Einwand, der Kläger habe in einen volatilen Markt investiert und hätte, wenn er die Aktien der Beklagten nicht gekauft hätte, ein unsichere Anlageentscheidung getroffen, bewegt sich im Bereich rechtlich nicht fassbarer Spekulation."). In those cases where lost profits on hypothetical alternative investments were demanded, courts have more often than not rejected the claim. See for instance Belgium: Brussel 3 October 2006, *DAOR* 2007, 227-238, with ann. by S. DELAEY (although the court allowed the investors to keep the dividend to compensate for missed opportunities); Brussel, 6 August 1992, *TBH* 1992, 813-814 (*Wagons-Lits*). Only the French courts – generally in the context of the loss of a chance – have shown willingness to compensate in this regard.

[1299] *Supra*, para. 554.

[1300] With regard to the US (statutory) prospectus rules: section 11 of the Securities Act (1933) applies to misleading registration statements, whereas section 12 Securities Act 1933 applies to misleading prospectuses. The damages to which an investor is entitled according to s.11 Securities Act is somewhat complex as it concerns the difference between the purchase price, which may not exceed the price at which the securities were offered to the public, and (1) the price of the securities at the moment the suit is filed; (2) in case the securities have been sold before the suit is filed, the damage shall represent the difference between the purchase price and the price for which they have been sold; or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages under option (1). According to s.12 Securities Act, an investor is allowed to "recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security". s. 11 Securities Act 1933 (and particularly s. 11 (e)); s. 12 Securities Act 1933 as amended by the Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (1995) codified in scattered sections of 15 U.S.C. (and particularly s.12 (b)).

[1301] See the references in the previous ftn.

[1302] See *supra*, para. 149.

entered into the transaction, the German courts and the prevailing opinion in German literature rejects this concept of 'modified rescissory damages'.[1303]

364. Mispricing damages ('*Kursdifferenzschaden*'). – Notwithstanding the rejection of alternatives for the rescissory measure discussed in the preceding paragraph, however, for claims for wrongful ad hoc disclosures based on §§37b, c WpHG, an alternative to rescission has been developed and accepted in German courts. In line with the general principles underlying civil liability law, the draft legislation of §§37b, c WpHG indicates that investors are to be restored in the situation as he would have been absent the wrong, but does not elaborate on the intended concept and measure of damages, however. As a result, courts and literature have advanced diverging opinions on the matter. The prevailing opinion holds that the rescissory measure is exaggerated and problematic as it shifts all losses suffered in the period during which the investor held the securities to the wrongdoer, changing the liability regime into an investor insurance system.[1304] This strand of literature therefore suggested that investors are only entitled to compensation for the difference between the price paid and the hypothetical price that would have been paid had the information been disclosed in a correct manner (mispricing damages or '*Kursdifferenzschaden*').[1305] The proponents of this approach support this interpretation of the law by reference to the function of ad hoc disclosures on the one hand, and the wordings used in the explanatory memorandum on the enactment of §§37b, c WpHG on the other. More particularly, rather than stating that erroneous ad hoc disclosure may distort investment decisions, the draft legislation mentions that erroneous ad hoc disclosures cause investors to sell their securities 'too cheap', respectively purchase securities 'too expensive'.[1306] Secondly, these commentators also draw support from the fact that besides protecting investors by enabling them to make informed decisions, continuing disclosure obligations also aim to ensure market integrity since an adequate disclosure system prevents market abuse and price manipulation.[1307] As the legislation thus aims to protect investors against manipulated or incorrect market prices, a remedy based on the distortion of securities prices is considered better suited than the traditional rescissory remedy based

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[1303] HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 184, with references cited, including BGH, 5 July 1993, II ZR 194/92, *BB* 1993, 2108. The assumption that another investment decision would have been taken but for the misrepresentation underlies the concept of reliance in investor litigation and thus leads more or less automatically to rescissory damages as a result. This includes losses due to general market loss.

[1304] See for this criticscm *supra*, para. 360 and references cited.

[1305] HELLGARDT, *Kapitalmarktdeliktsrecht*, 504; K.J. HOPT, 'Die Haftung für Kapitalmarktinformationen', *WM* 2013, 106. The prevailing view holds that only '*Kursdifferenzschaden'* were recoverable. See for instance HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 199; WAGNER, 'Schadensberechnung', 495; SETHE in ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §§ 37b, c, para. 13-16 and para. 72; CASPER, 'Significance of the Law of Tort', 99; K.J. HOPT and H.C. VOIGT, 'Prospekt- und Kapitalmarktinformationshaftung – Recht und Reform in der Europäischen Union, der Schweiz und den USA', *WM* 2004, heft 37, 1804; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 128. Others argued in favor of the rescission measure – in addition to the option to claim '*Kursdifferenzschaden*' – however. See for instance: HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c WpHG, para. 245 ff.; VEIL, 'Die Haftung des Emittenten für fehlerhafte Information des Kapitalmarkts nach dem geplanten KapInHaG', 97; MÖLLERS, Organhaftung, 2107, para. 23.

[1306] "Dieser Anleger hätte nämlich in Kenntnis der negativen Tatsache die Wertpapiere nicht zu dem von ihm entrichteten Preis erworben; er hat die Wertpapiere also „zu teuer" gekauft. Der Anleger ist so zu stellen, als ob der Emittent seine Pflichten ordnungsgemäß erfüllt hätte." Begründung zum Regierungsentwurf 4. Finanzmarktförderungsgesetz, in: Gesetzentwurf der Bundesregierung (Regierungsentwurf) zur weiteren Fortentwicklung des Finanzplatzes Deutschland (Viertes Finanzmarktförderungsgesetz), BT-Drucks. 14/8017, 18 January 2002, available at: http://dip21.bundestag.de, p. 93 ff.

[1307] See on the dualist function of continuing disclosure obligations for instance: CASPER, 'Significance of the Law of Tort', 91; HELLGARDT, 'Praxis- und Grundsatzprobleme', 677; SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, §1 WpHG, para. 4; HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§37b, c WpHG, para. 7 ff.; ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §§37b, c WpHG, para. 9 ff.

on a distortion of investment decisions, it is reasoned.[1308] As a result, investors should be entitled to the price difference caused by the wrongful disclosure, but not on the total loss resulting from the deficient investment decision. This different approach towards loss (and causation) is not discussed in more detail at this point, but elaborated on in the next chapter.

365. Although the mispricing loss appears well accepted in the context of claims for erroneous ad hoc disclosures based on §§37b, c WpHG by now, German courts initially displayed reluctance and adhered to the traditional approach and the rescissory measure, both with regard to primary and secondary market transactions. A (first) shift in the BGH's position was noticed in the stream of decisions issued following the *Neuer Markt* scandals. Since §§37b, c WpHG had not been enacted at the time, the claims for misleading ad hoc and periodic disclosures were based on §826 BGB and dealt with under the traditional reliance approach. Notwithstanding its adherence to the traditional framework, however, the BGH did adopt a new approach in defining the recoverable loss. In its EM.TV decision for instance, the BGH particularly held that besides the traditional rescission measure, investors can also be compensated for the difference between the price paid for the securities and the value of the securities as they would have been priced without the manipulation through deficient disclosures.[1309] Since investors were required to prove reliance in both scenarios however[1310] the only difference concerns the fact that the investor can keep the securities instead of returning them in exchange for the price paid as is the case in the rescission scenario.[1311] As the damages received under the measure of the mispricing loss equal the price distortion caused by the misrepresentation, it seems fair to say that the latter would generally be lower than the damages received under the rescission measure.[1312] The German Supreme Court is rather scarce with arguments supporting its view on causation and loss and limits its motivation to the statement that the requirement of causation must be the same for all claims brought on the basis of §826 BGB, regardless of which type of compensation is demanded.[1313] Hence, regardless of whether rescissory damages or mispricing

[1308] See the references cited in the previous ftn.

[1309] BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV). In this decision, the BGH rejected two lower court decisions holding that the rescission measure was inappropriate in this kind of cases and that instead damages should be measured based on the effect of the misrepresentation on the price. ("Die [Klägers] begnügen sich damit, den angeblichen Schaden aus dem Kauf einer bestimmten Anzahl von Aktien zum Tageskurswert unter Hinzurechnung von Spesen und unter Abzug eines evtl. Verkaufserlöses zu berechnen. Dies genügt jedoch nicht den Anforderungen an eine konkrete Schadensberechnung, wonach die tatsächlich eingetretene Vermögensminderung und die ausbleibende Vermögensmehrung bezogen auf das vorgeworfene, schädigende Verhalten maßgeblich ist (vgl. Palandt/Heinrichs, Vorb. § 249 Rdnr. 50). Erforderlich wäre daher gewesen, den konkreten Einfluss einer - hier als unwahr unterstellten, beschönigenden - Mitteilung […] auf den Kurswert der Aktie unter Angabe eines konkreten Euro-Betrages darzustellen und hierfür im Bestreitensfalle Beweis anzubieten."). Consult: OLG München, 18 July 2002, *NJW-RR* 2002, heft 24, 1702; ann.: *EWIR* 2003, heft 2, 87.

[1310] See: BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV). See also: BGH 19 July 2004, II ZR, 218/03, *BB* 2004, heft 34, 1812. See (amongst others) on these decisions and the approach laid out by the BGH: WAGNER, 'Schadensberechnung', 504-505; CASPER, 'Significance of the Law of Tort', 99, ftn. 25; HELLGARDT, 'Praxis- und Grundsatzprobleme', 673; MÖLLERS, 'Das Verhältnis der Haftung', 1637; T.M.J. MÖLLERS, 'Das Verbot der Einlagenrückgewähr und das Verbot des Erwerbs eigener Aktien steht der Haftung der AG für die von ihrem Vorstand durch falsche Adhoc-Mitteilungen begangenen sittenwidrigen vorsätzlichen Schädigungen nicht entgegen - EM.TV', *BB* 2005, heft 31, 1644; MÖLLERS, Organhaftung, 2107, para. 24.

[1311] Note that in case it concerns a claim holding that the securities would have been sold (earlier) in absence of the wrong, the investor is not entitled to damages corresponding with the purchase price, but instead based on the hypothetical price they would have received in case of sale. BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV).

[1312] Extensively: WAGNER, 'Schadensberechnung', 495: HELLGARDT and KOWALEWSKI, 'Stand der Rechtsprechung', 1840.

[1313] BGH, 28 November 2005, II ZR 246/04, available at http://juris.bundesgerichtshof.de, para 9 in particular: "Das Erfordernis eines Nachweises des Anlegers, dass die unrichtige Ad-hoc-Mitteilung ursächlich für seinen Kaufentschluss war, hängt nicht etwa von der gewählten Schadensart ab, sondern gilt für die im Rahmen des § 826 BGB als Rechtsfolge in Betracht kommende Form des Schadensersatzes gemäß § 249 BGB - Naturalrestitution und Differenzschaden - in gleicher Weise." See also: MAIER-REIMER/SEULEN in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 114, 171 and 173 in particular.

damages are claimed, causation in claims based on § 826 BGB implies that an investor must have been induced to effectuate the transaction by the alleged misrepresentation.[1314] From a conceptual point of view however, the BGH-decision appears precarious and inconsistent.[1315] Since the concept of mispricing loss implies that the investor has not effectuated a given transaction as a result of an alleged misrepresentation, but instead assumes that the loss consists of the price distortion resulting from that misrepresentation, requiring transaction causation to be established in an entirely similar manner as is the case in the transaction model does not make much sense. Yet, the prevailing view in the literature approved the BGH position on causation under §826 BGB.[1316]

366. In its most recent decision on the matter, the BGH went a step further and held that reliance is no longer needed in order to be entitled to damages based on the price manipulation when claimed on basis of §§ 37b, c WpHG.[1317] Based on this latter point of view, investors are still required to establish reliance in case they claim damages according to the rescission measure but not in case they are satisfied with redress according to the price inflation or deflation that resulted from the wrongful disclosure(s).[1318] The newly adopted concept of recoverable loss along with its implications in terms of causation is discussed in the next chapter. It is stressed that this newly adopted approach coexists with the traditional reliance approach that entitles investors to damages according to the rescission measure, provided that in the latter case reliance is established according to the strict norms set out by the BGH. As the provisions laid down in §§37b, c WpHG only offer a cause of action to investors filing claim following erroneous ad hoc disclosures, it is unclear whether the alternative concept of causation also applies with regard to periodic disclosures is unclear.[1319]

C. Limitations

1. Contributory negligence

367. According to general principles of civil liability law, compensatory damages to which victims are entitled may be reduced under certain circumstances, corresponding to the (portions of) losses caused by their own fault. Although recurrently applied in the context of investment services, this

[1314] MAIER-REIMER/PASCHOS in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 118.

[1315] Also: MÖLLERS, Organhaftung, 2107, para. 24; LEUSCHNER, 'Kausalitätserfordernis unrichtigen Ad-hoc-Mitteilungen', 1050.

[1316] See for instance: H. FLEISCHER, 'Zur deliktsrechtlichen Haftung der Vorstandsmitglieder für falsche Ad-hoc-Mitteilungen', *DB* 2004, heft 38, 2034; T.M.J. MÖLLERS and F.C. LEISCH, 'Haftung von Vörstanden gegenüber Anlegern wegen fehlerhafter ad-hoc-meldungen nach §826 BGB', *WM* 2001, heft 35, 1656 (advancing this point of view already prior to the BGH-decision). TEICHMANN on the other hand observes that the BGH applies a too narrow concept of causation, whereas the scope of the damages is too generous as it also covers for losses unrelated to the fraud. TEICHMANN, 'Haftung für fehlerhafte Informationen am Kapitalmarkt', 956. For an overview of the reactions in the literature: LEUSCHNER, 'Kausalitätserfordernis unrichtigen Ad-hoc-Mitteilungen', 1051 and ftn. 14 ff. in particular. As the latter also remarks, the approval of the traditional requirement of causation appears limited to claims based on §826 BGB. When claiming in the context of §§ 37b, c WpHG however, other interpretations of causation prevail, including the authors approving of the traditional interpretation in the light of §826 BGB. See also *supra*: para. 364 and the references cited with regard to the interpretation of '*Kursdifferenzschaden'* in §§ 37 b, c WpHG.

[1317] BGH, 13 December 2011, XI ZR 51/10, (IKB), available at: http://juris.bundesgerichtshof.de; see also: *BB* 2012, 530 with ann. by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537-538; for other comments on the decision see also: KLÖHN, 'Die Haftung wegen fehlerhafter Ad-hoc-Publizität', 345; HOPT, 'Die Haftung für Kapitalmarktinformationen', 106; W.H. VON BERNUTH, E. WAGNER and R.M. KREMER, 'Die Haftung für fehlerhafte Kapitalmarktinformationen: Zur IKB-Entscheidung des BGH', *WM* 2012, heft 18, 836 in particular; HELLGARDT, 'Praxis- und Grundsatzprobleme', 673.

[1318] This point of view had been adopted in the German academic literature for several years prior to the BGH's decision. See CASPER, 'Significance of the Law of Tort', 99-100 and the overview of literature presented in ftn. 26 in this regard.

[1319] See *infra*, para. 382 and Part III, Chapter II, para. 422.

seems to be less the case in the context of market disclosures[1320], although some examples are available. Assessing a claim for loss following misleading information contained in an investment brochure for instance, the Dutch Supreme Court considered that the investors had been negligent and contributed to the loss because they did not engage in a more thorough inquiry as may be expected from experienced professionals like them, despite the fact that a careful reading of the brochure revealed that the forecasts on which the investors relied were not supported by verifiable sound figures.[1321] German literature on the other hand shows restraint in applying contributory negligence ('*Mitverschulden*').[1322]

2. Reference date: fixation of recoverable loss and mitigation of loss

368. A recurrent issue in several Member States concerns the question whether an investor who suffered losses following misleading issuer disclosures should be obliged to sell off the securities at matter once it becomes clear that he has been deceived. More particularly, some have argued that the securities acquired following the wrongful information must be sold in order for the loss to materialize. Only when it is shielded from future price fluctuations, the loss becomes sufficiently certain and qualified for recovery according to these authors.[1323] By contrast, others have reasoned that the aforementioned reasoning is flawed and that there is no need to require a sale in order to be eligible for compensation.[1324] The latter point of view was also adopted and defended in this thesis for the reasons explained in one of the previous chapters.[1325] It was asserted that setting an appropriate reference date to fix loss is the better solution to the problem, as it is less rigid and simultaneously succeeds in aligning risk with responsibility. More particularly, if an investor-claimant chooses to retain the investment after becoming aware of issuer's misconduct, there is no particular reason to preclude the investor from doing so, provided that the losses incurred from that point in time on should be borne by the investor himself.[1326] Put differently, once inaccuracies or incomplete information that affected investment decisions have been rectified trough corrective disclosures or otherwise made public, investors are able to reconsider their actions and may decide to dispose of the securities or retain the instruments and accept the risk on future price deprecations. The consequences of retaining the securities – and acceptance of the risks involved – should be borne by the investor, rather than being shifted to the wrongdoer. Along the same lines, potential recoveries occurring after this point in time and for reasons unrelated to the misconduct should have no impact on the damages awarded by

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[1320] *Supra*, para. 288 ff.

[1321] (The Netherlands) HR, 20 May 2008, JOR 2008/209 with ann. by B.J. de Jong (De Boer c.s./TMF), r.o. 4.2.

[1322] HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 123, with reference to OLG Frankfurt, 19 July 2005- 5 U 182/03, *AG* 2005, 851, 853. The decision in the context of §13 VerkProspG.

[1323] See for instance: MAGNIER, 'Information boursière et préjudice des investisseurs', 560.

[1324] DE JONG, *Schade door misleiding*, 179; SPITZ, *La réparation*, 236, para 380 ff.; HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 124; MAIER-REIMER/SEULEN in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 183.

[1325] See particularly the discussion on virtual losses v. materialized loss in the context of liability for investment services, see *supra*: Part II, Chapter II, para. 240 ff.

[1326] Similar: SPITZ, *La réparation*, 236, para 380 ff.; RICHTER, *Schadenszurechnung*, 203-204; BARTH, *Schadensberechnung*, 204-212; MAIER-REIMER/SEULEN in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 183. Note however that part of the German literature rejects this solution. See for instance: HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 124; ASSMANN and SCHÜTZE, *Kapitalanlagerechts*, §6, para. 241. See also the overview of literature in BARTH, *Schadensberechnung*, 207; and: MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 364-365. It is noted that the BGH has not clearly answered the question when the matter surfaced in one of the Infomatec-decisions: BGH 19 July 2004, II ZR 402/02 (Infomatec), available at: http://www.bundesgerichtshof.de or *ZIP* 2004, 1593, 1599.

courts either. For these reasons, it is repeated that it is advisable to fix the loss at that point in time when the misrepresented information is publicly rectified[1327], provided that investors are given reasonable time to make an informed decision in the circumstances of the case and avoid selling at panic prices that may occur shortly after corrective disclosures are made.[1328] Especially in case the truth only gradually unfolds by consecutive disclosures for instance, or when it concerns retail investors, courts may have to take these specific circumstances into account.[1329] Furthermore, in those cases were investor-claimants cannot sell the securities upon discovering the truth (e.g. lock in-regulation), the rules should be applied with reasonable lenience too.[1330]

369. It is noted that a similar result may be achieved by applying the duty to mitigate losses. The obligation to mitigate losses specifically implies that the victim of wrongdoing is responsible to attempt to mitigate the loss once it has emerged under the obligation to be held responsible for the accrual of the loss due to a failure to mitigate, while being entitled to recover the costs of mitigation regardless of whether the attempt proves successful. Considered in the context of wrongful issuer disclosures, the duty to mitigate losses resulting from those misrepresentations may result in an obligation for the investor to dispose of the securities in order to prevent an accrual of loss due to further price fluctuations. To the extent investors do not sell and instead choose to retain the investment, potential price declines (or improvements) occurring after this point in time are attributable to the investor.

3. Deduction of benefits

370. A final consideration in assessing damages concerns the potential benefits an investor may have enjoyed because of the investment, such as dividends or coupons. More particularly, insofar originating from the same source as the injury suffered, the loss is offset against the benefits. The remainder of the loss is then considered the actual compensation to which the victim is entitled. Examples of this principle are numerous, as is illustrated in the literature and mostly concern the deduction of dividends and coupons received, or tax advantages.[1331] Other examples concern series of similar investment contracts concluded in contravention of the rules that caused an investor to suffer loss, yet also generated profit during the relevant period in which the contracts were carried out.[1332]

III. The difference between liability rules for deficient prospectus and continuous disclosures examined

[1327] RICHTER, *Schadenszurechnung*, 203-204; BARTH, *Schadensberechnung*, 204-212; SPITZ, *La réparation*, 236, para 380 ff.; BAUMS, 'Haftung Falschinformation', 187-188.

[1328] A solution in this regard may consist of the introduction of a bounce back-rule, as discussed further below (*infra*: para. 484).

[1329] RICHTER, *Schadenszurechnung*, 203-204; BARTH, *Schadensberechnung*, 211.

[1330] The decision in *Smith New Court Securities* by the House of Lords for instance explicitly referred to the lock-in rules and allowed compensation based on the date of the delayed sale since another outcome was found unreasonable. Smith New Court Ltd. v. Scrimgeour Vickers (1997), AC 254.

[1331] BARTH, *Schadensberechnung*, 212; MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 314-315.

[1332] To the extent sufficiently closely related and interconnected, the series of investment contracts are considered the source of the loss as a whole, implying that the profits made on (some of) these contracts must be netted with the loss. For an example of the latter, see for instance: BGH, 15 January 2013, II ZR 90/11, *WM* 2013, 456.

371. The analysis allows for the conclusion that very similar problems were observed regarding the application of the concepts of causation and loss in investor suits for violations of primary and secondary market disclosures. It was also demonstrated that legislative and judicial interventions have facilitated investor claims for deficient prospectus information in various Member States to resolve the difficulites, yet these facilitations do generally not extend to claims for violations of secondary market disclosures. The reasons underlying the differentiation between the treatment of causation and loss depending on whether it concerns primary or secondary market information has drawn little attention and has often not been clearly motivated by the legislator or legislative texts and scholarly literature. For instance, the Belgian and UK preparatory documents to the statutes that introduced a causal presumption for prospectus liability claims clarifiy that the motivation to introduce a causal presumption related to the evidential difficulties investors were found struggling with[1333], but do not offer an explanation as to why no similar action has been undertaken with regard to continuing disclosure obligations, even though investors stumble upon the very same problem in the latter situation. This section briefly explores the potential explanations raised in the case law and literature for the different treatment of the causation requirement depending on whether it concerns deficient primary or secondary market information.

A. *The prospectus as a sales and promotion instrument*

372. Whilst the German legislator did not expressly state its reasons to differentiate between liability claims brought on the legal basis provided by the former §§44-45 BörsG (currently §21 WpPG) and those filed according to §§ 37b, c WpHG, the German Supreme Court has discussed the matter more than once in recent decisions.[1334] Although the German Supreme Court confined itself to finding that the causal presumption laid down in the former §§44-45 BörsG was not 'transferable' to secondary market litigation simply because the legislator did not provide for it in the statutory provisions relating to liability for ongoing disclosure obligations,[1335] the court did elaborate on the differentiated liability rules with regard to the applicability of the doctrine of *Anlagestimmung* pursuant to an appellate decision that had allowed for a relaxation of the evidential standards of causation based on the theory of *Anlagestimmung*.[1336]

373. As a justification for its refusal to extend the doctrine of *Anlagestimmung* to secondary market liability cases, the German Supreme Court pointed out that contrary to prospectuses, continuing disclosures do not provide a comprehensive set of information relevant to investors deciding on whether or not to purchase securities. Likewise it is held that continuing information is not aimed at boosting the interest of the investor public in the way prospectuses generally do.[1337] More particularly,

[1333] *Supra*, para. 327 and references cited in ftn. 1167.

[1334] See for instance BGH, 13 December 2011, XI ZR 51/10, (IKB), *BB* 2012, 530 with ann. by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537-538; and the decisions cited in the footnotes below.

[1335] The court particularly reasoned that the legislator was aware of the difficulties investors encounter both liability cases following primary and secondary market information, yet proceeded to introduce a presumption exclusively with regard to misleading prospectuses. The legislator's refusal to enact a similar presumption in the context of secondary market information should not be disregarded by the courts via the introduction of a judicial presumption, according to the BGH. See: BGH, 13 December 2011, XI ZR 51/10, (IKB) available at: http://juris,.bundesgerichtshof.de, para. 62. In the same sense for a number of reasons see: BARTH, *Schadensberechnung*, 166.

[1336] OLG München, 28 April 2005, (ComROAD III), *ZIP* 2005, 1141-1144.

[1337] OLG München, 14 May 2002, *ZIP* 2002, heft 38, 1727-1730; BGH, 13 December 2011, XI ZR 51/10, (IKB) available at: http://juris,.bundesgerichtshof.de, para. 24; see also: *BB* 2012, 530 with ann. by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537-538; BGH, 19 July 2004, II ZR 217/03 (Infomatec), at p. 22-23; II ZR 218/03 (Infomatec), at p. 16; II ZR 402/02, (Infomatec), at p. 7 (all decisions cited available at: http://www.bundesgerichtshof.de). See also: BARTH, whereas prospectuses can be considered as (strictly regulated) sales instruments, secondary market disclosures are far more limited in aim and substance. As such their impact is far less profound and less likely to arouse similar market sentiments compared to the effect prospectuses may have.[1338] This is not to say however that *Anlagestimmung* may never apply to ongoing disclosure obligations. Although exceptional, it may well be that courts – on a case by case basis and supported by circumstantial evidence – find that in an individual case *Anlagestimmung* does apply.[1339]

374. The German Supreme Court also explained that apart from *Anlagestimmung*, no other presumption can be applied in the context of secondary market transactions either. The aforementioned '*Vermutung aufklärungsrichtigen Verhaltens'* for instance applies to investment decisions based on specific information or advice with regard to a particular investment in which the investor is interested. Based on the information, the investor can consider the advantages and disadvantages and decide whether or not to invest. Continuing disclosures cannot compare to the specifics of this setting because investors may be triggered by stock price movements rather than directly by the disclosure itself. As a result, allegations of (direct) reliance on secondary market disclosures cannot be presumed but must be supported by evidence, according to the German Supreme Court.[1340]

B. Fear for opening the floodgates and policy considerations

375. The expansion of the *Anlagestimmung* regime to secondary market information was not only attempted in court. In the drafting process of legislation aimed at introducing capital market information liability to be imposed on the (board of) directors and the executive management, one of the draft provisions extended the doctrine of *Anlagestimmung* to ad hoc disclosures via a newly drafted article §37b *Kapitalmarktinformationshaftungsgesetz* (Capital Market Information Liability Act or "KapInHaG").[1341] Provided that plaintiffs succeed in the establishment of an influential market

Schadensberechnung, 170. *Contra*: MÖLLERS and LEISCH, 'Haftung von Vörstanden', 1656 ff.; SETHE in H.D. ASSMANN and U.H. SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, Köln, Verlag Dr. Otto Schmidt, 2009, §§37 b, c WpHG, para 12 ff.; SETHE in H.D. ASSMANN and U.H. SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, Köln, Verlag Dr. Otto Schmidt, 2009, §§37 b, c WpHG, para. 27.

[1338] BGH, 13 December 2011, XI ZR 51/10, (IKB) available at: http://juris.bundesgerichtshof.de; see also: *BB* 2012, 530 with ann. by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537-538; BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560 at para. 13 ff.; BGH, 4 June 2007, II ZR 173/5 (ComROAD V) para. 13 ff.; BGH, 19 July 2004, II ZR 217/03 (Infomatec), at p. 21-22; *BB* 2004, heft 34, 1812; *NJW*, 2004, 2668; (all decisions cited are also available at: http://www.bundesgerichtshof.de). See also: OLG Frankfurt/Main, 17 March 2005, n° 1 U 149/04, *BB* 2005, heft 31, 1648; See in the same sense: HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 138; BARTH, *Schadensberechnung*, 166 ff.; HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 207.

[1339] In one of the *Informatec*-decisions for instance, the court considered that a time span of 9 and 6 months in between the (ad hoc) disclosure of the misleading information and the actual acquisition of the shares is too long to assume that the investor has bought them in the flow of the market euphoria created by the misleading ad hoc information. Notwithstanding its rejection, the BGH did imply that in case the time span between the disclosure and the acquisition had been considerably shorter, the court might have accepted the application of *Anlagestimmung*. BGH, 19 July 2004, II ZR 218/03 (Infomatec), at p. 12-13; (all decisions cited available at: http://www.bundesgerichtshof.de). For an overview of the *Neuer Markt*-case law, see also: CASPER, 'Significance of the Law of Tort', 97-100.

[1340] "Diese Vermutung sichert das Recht des Anlegers, der konkret in eine Anlage investieren will, in eigener Entscheidung und Abwägung des Für und Wider darüber zu befinden, ob er in ein bestimmtes Projekt investiert oder nicht […]. Diese Konkretisierung auf eine bestimmte Anlageentscheidung fehlt der Ad-hoc-Mitteilung, auch wenn durch sie der Kurs eines Finanzinstruments beeinflusst wer-den kann und dadurch auch Reaktionen der Anleger ausgelöst werden können." BGH, 13 December 2011, XI ZR 51/10, (IKB) available at: http://juris,.bundesgerichtshof.de, para. 62. In the same sense for a number of reasons see: BARTH, *Schadensberechnung*, 186-188.

[1341] Extensively: See also: WAGNER, 'Schadensberechnung', 501; C. DUVE and D. BASAK, 'Welche Zukunft hat die Organaußenhaftung für Kapitalmarktinformationen?', heft 49 *BB* 2005, 2645; E. SÜNNER, 'Ungereimtheiten des Entwurfts eines Kapitalmarktinformationshaftungsgesetz', *DB* 2004, heft 46, 2460; VEIL, 'Die Haftung des Emittenten für fehlerhafte sentiment, causation between the investment mood and the transactions would be assumed insofar the transactions took place within three months following the emergence of the investment mood. The draft was never transposed into law however due to fear for a too far-reaching liability regime that would undermine the competitiveness of the German capital markets.[1342] German courts as well pointed out that facilitating investor litigation for secondary market information claims by means of causal presumptions and the like would result in an endless expansion ("*uferlosen Ausweitung"*) of liability claims.[1343]

Similar concerns in terms of speculative and excessive investor litigation prompted by procedural facilitations in the context of liability for ongoing issuer disclosure were observed in the UK.[1344] With regard to the reform of the liability regime applicable to violations of continuing disclosure obligations, the UK government ordered an independent review, to be drafted by Prof. DAVIES, and invited interested parties to submit comments and recommendations with regard to the questions raised in the review.[1345] The overall objective pursued with the reform was to balance "the interests of issuers and investors, providing appropriate incentives to make timely and accurate disclosures in compliance with statutory rules, as well as an appropriate right to recover losses."[1346] The review eventually recommended a rather limited role for private enforcement of continuing disclosure obligations by requiring fraud as the standard of liability, while the rules laid down in s.90A FSMA can only be invoked against issuers.[1347] Directors, management, advisors and other third parties are excluded from the reach of s.90A FSMA. With regard to causation and damages, it was also recommended to adhere to the tort of fraud, yet with one facilitation, being the elimination of the requirement that a claimant presents evidence of the defendant's intention that the recipient of the misleading statement would rely on it.[1348]

As a justification for the rather restrictive scope of s.90 FSMA, it was argued that more generous liability rules would enhance speculative and unmeritorious claims by large groups of investors, which might cause issuers to settle rather than litigate to trial. Secondly, it was also asserted that a broader liability system, based on negligence or gross negligence rather than fraud, might impose a very substantial financial burden on issuers if a stock had been heavily traded during the period in which the market had been deceived by the deficient disclosures.[1349] Furthermore, the review also indicated that the introduction of a negligence standard was also unnecessary as long as a sound public enforcement system is in place to ensure compliance. Moreover, contrary to private litigation, a

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Information des Kapitalmarkts nach dem geplanten KapInHaG', 91; SETHE in H.D. ASSMANN and U.H. SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, Köln, Verlag Dr. Otto Schmidt, 2009, §§37b, c WpHG, para. 26 ff.; TEICHMANN, 'Haftung für fehlerhafte Informationen am Kapitalmarkt', 959.

1342 Some authors also refer to the intense lobbying that took place to prevent the enactment of the KapInHaG. See for instance: PAPST, 'Germany', 7-8.

1343 BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560; also available at: http://www.bundesgerichtshof.de, and specifically para. 16. For an English (non-official) translation of the decision: CAHN and DONALD, *Comparative Company Law*, 535 ff. See on the topic (in English) also: *the Law of Tort',* 98.

1344 DAVIES, 'Davies Review: Final Report', 11, para. 12 ff.

1345 DAVIES, 'Davies review. Discussion paper', (2007), 62 p.

1346 *Ibid.*3, stated in the (second paragraph of the) invitation to comment.

1347 DAVIES, 'Davies Review: Final Report', 14, para. 19. See also: DAVIES, 'Liability for misstatements', 306.

1348 DAVIES, 'Davies Review: Final Report', 18, para. 30.

1349 *Ibid.* 11. Defending the choice for the liability standard of fraud, it was also pointed out that "[t]he prospect of a very large liability for only a very minor deviation from the standard of conduct of the reasonable person is likely to induce potential defendants to stay well on the nonliability side of the line, and, as part of that, to engage in 'defensive' and unhelpful disclosure."

supervisor can impose penalties matching the degree of fault and prevent the danger of over-enforcement.[1350]

376. A final, repeatedly cited reason as to why there is a fundamental difference between prospectus liability and liability for continuous disclosures holds that different mechanisms may be driving the dissemination of misleading information, which require a different treatment. More particularly, whereas the proceeds of an offering benefit the issuer, i.e. the company and its shareholders directly, this is not invariably the case for ongoing disclosures.[1351] Once securities have been offered and distributed to the markets in return for capital for the issuer, the issuing company and its shareholders generally do not gain direct benefits from (misleading) continuous disclosures and transactions effectuated on the secondary market. Instead, scholarly research has drawn attention to the correlation between poor firm performance and the occurrence of deficient continuous reporting, and suggests that deficient ongoing disclosures might be motivated by self-interest on the level of directors, managers and company officers.[1352] It was particularly asserted that directors and officers may directly and personally benefit from misrepresentations, rather than the issuing company or its shareholders as such. Rather than targeting the issuer with floods of claims, an alternative approach directed against and tailored to wrongdoing motivated by self-interest by directors and officers may be better suited and more effective. This topic is elaborated on in the next chapter[1353], yet at this point, we conclude that even though there might be pressure to disclose positive announcements to uphold a reputation and avoid disquieting creditors, the fact that the issuer is not directly benefitting from these disclosures in financial terms may offer another explanation for the restraint towards holding the issuer liable for misreporting other than prospectuses in courts and legislative initiatives.

377. Assessment. – The preceding paragraphs demonstrate that the differentiation between primary and secondary market liability is based on reasons that allude to the floodgate-argument, consideration as to the effectiveness of a broad liability system applicable to secondary market misstatements, and the purpose of information provided in prospectuses compared to information contained in continuous disclosures. More particularly, besides informing the market on an offering, prospectuses have also been considered promotion material aimed at arousing the investor public’s interest. As the legislation indicates, prospectus must therefore contain all information relevant for investors to make an informed investment decision. Ad hoc and periodic information obligations on the other hand, are mostly concerned with timely updates and announcements of price sensitive information and aim to ensure price and market integrity. As has been recurrently stated by the German Supreme Court, many investors do not decide to trade securities on the mere basis of a single ad hoc announcement, but take ad hoc announcements into account along with myriad other elements to decide on investments and

[1350] *Ibid.*14, para. 19. See also: DAVIES, 'Liability for misstatements', 306.

[1351] F. EASTERBROOK and D.R. FISCHEL, 'Optimal damages in securities cases', 52 *U. Chi. L. Rev.*, 1985, 641; also: D.C. LANGEVOORT, ‘Capping Damages for Open-Market Securities Fraud’, 38 *Ariz. L. Rev.*, 1996, 646; DAVIES, 'Liability for misstatements', 300; J. C. COFFEE, 'Reforming the Securities Class Action: An Essay on Deterrence and its Implementation', *Colum. L. Rev.*, 2006, 1556; B. BLACK, 'Should the SEC Be a Collection Agency for Defrauded Investors?’, 63 *Bus. Law.*, 2007-2008, 322; RICHTER, *Schadenszurechnung*, 11 ff.; DAVIES, 'Liability for misstatements', 300.

[1352] See on this topic: J. ARLEN and W.J. CARNEY, 'Vicarious Liability for Fraud on Securities Markets: Theory and Evidence', *U. Ill. L. Rev.*, 1992, 691. See also: J.M. FRIED and N. SHILON, 'The Dodd-Frank clawback and the problem of excess pay'', *The Corporate Board*, 2012, 15. See also *infra*, para. 517 and the references cited.

[1353] The objections raised in the UK and the DAVIES review in particular against a broad issuer liability system for deficient continuous reporting obligations (comparable to prospectus liability claims) also relate to the so-called circularity problem, the implications of D&O liability and the far for opening the floodgates. DAVIES, 'Davies Review: Final Report', para. 57. See also Part III, Chapter II, *infra*, para. 424.

trading.[1354] For these reasons, the mere reversal of the burden of proof regarding (transaction) causation indeed seems a rather artificial solution in the context of secondary market disclosure. However, even though the different treatment may be based on objective differences in aim and substance of the information conveyed to the public in prospectuses and continuous disclosurs, this difference should not preclude effective and sound liability rules on which wronged investors can rely to obtain relief. To the extent differences exist, these differences call for an adjusted solution, tailored to the specific setting to which the rules apply. In line with these considerations, the second chapter of this part aims to discuss and develop a more effective approach to causation and damages tailored to secondary market misstatements.[1355]

C. The potential impact of the EU principle of effectiveness ('Effet utile')

378. As indicated in the preceding paragraphs, various explanations have been advanced to explain the difference between liability regimes applicable to misleading prospectuses and those applicable to secondary market disclosures. Yet it may be questioned whether these differences withstand the EU obligations to provide effective liability rules as is required in the light of art. 7 Transparency Directive.

1. The principle of effectiveness in the light of art. 7 Transparency Directive

379. Assessing investor claims for misleading prospectus information, the Dutch Supreme Court took on an interesting point of view as it invoked EU law and the EU courts' case law to adjust the Dutch prospectus liability rules.[1356] More particularly, holding that the EU prospectus directive obliges the Member States to provide for an *effective* liability system to remedy investor losses following violations of the EU prospectus rules, the Dutch Supreme Court introduced a presumption of reliance to resolve the difficulties investors encountered in obtaining compensation.[1357] The court held that not doing so would render the EU legislation meaningless and run counter to the obligations of Member States to effectively carry out EU legislation.[1358] Since the Transparency Directive contains a highly similar provision[1359], the question has thus arisen whether this obliges the Dutch Supreme Court – and by extension possibly other Member States too[1360] – to provide facilitations with regard to the requirement of causation issues in the context of periodic disclosures too.[1361]

[1354] See *supra*, para. 373 and the references to the case law cited.

[1355] Part III, Chapter II.

[1356] See also in this regard: DE JONG, 'Liability for Misrepresentation', 365-366.

[1357] HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht*, 2010, 21, with ann. by H.M. VLETTER-VAN DORT, para. 4.11.1. As already mentioned earlier, EU legislation has remained rather silent on the matter of private enforcement. The only reference to civil liability is found in the Prospectus Directive, UCITS and the Transparency Directive requiring the Member States to apply their national liability rules in case of breach. At first sight, this appears a rather limited and superficial requirement for this implies that Member States are compliant by merely declaring their civil liability rules applicable and not setting any less favorable standards than is the case in their national laws. The Dutch Supreme Court has however demonstrated that the potential of this provision should not be underestimated with respect to liability, including the assessment of (transaction) causation.

[1358] HR 27 November 2009, *JOR* 2010/43 with ann. by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht*, 2010, 21, with ann. by H.M. VLETTER-VAN DORT, para. 4.11.2.

[1359] Art. 7 Transparency Directive.

[1360] See for instance with regard to Germany: HELLGARDT, 'Europarechtliche Vorgaben', 161-162, 165. The author suggests that the BGH fails to comply with the requirement of effectiveness with regard to the obligations laid down in the MAD and the Transparency Directive due to its strict approach to causation and damages as displayed in the *Neuer Markt*-litigation. *Comp*.(The Netherlands): DE JONG, 'Liability for Misrepresentation', 353. Note however that the UK designed a statutory

380. It was asserted in this chapter that the effectiveness principle implies that procedural rules and evidentiary requirements may not render it excessively difficult or impossible for investors to enforce EU law when they have the individual right to do so.[1362] Whether the Member States meet this goal is subject to discussion however. With regard to Germany, for instance, HELLGARDT has asserted that the German law fails to comply with the requirement of effectiveness as it renders liability for periodic disclosures very difficult because of its strict approach to causation and damages as displayed in the *Neuer Markt*-litigation.[1363] Note, however, that the UK designed a statutory liability regime (s.90A FSMA) specifically to ensure compliance with the Transparency Directive but did not consider a presumption necessary or advisable in the context of continuing disclosures, contrary to its prospectus liability regime laid down in s.90 FSMA.[1364]

381. Assessment. – In the light of the analysis of the relevant EU legislative provisions, the principle of effectiveness and the ECJ-case law, it was concluded in the first part of this thesis that to the extent the evidential and procedural rule consistently preclude investors from obtaining compensation for violations of periodic information obligations, the principle of effectiveness requires the Member States to intervene and provide for an appropriate procedural framework within which the rights conferred on individuals can be privately enforced. Although the Dutch Supreme Court correctly holds that the effectiveness principle implies that procedural rules and evidentiary requirements may not render it excessively difficult or impossible for investors to enforce EU law when they have the individual right to do so, it should also be borne in mind that EU law and the EU courts generally leave it to the Member States to decide how to meet their obligations under EU law. The Dutch Supreme Court may consider a causal presumption appropriate – or even necessary – in the light the Dutch legal system, yet this does not imply that other Member States are equally required to employ similar presumptions. Alternative solutions may also adequately attenuate the problem. A range of solutions may be thought of, such as the loss of a chance doctrine or lower evidential burden, yet as several of the alternative solutions discussed in this chapter have proven susceptible to criticism too[1365], an alternative approach is discussed and examined in the next chapter.

liability regime (s.90A FSMA) specifically to ensure compliance with the Transparency Directive but did not consider a presumption necessary or advisable in the context of continuing disclosures, contrary to its prospectus liability regime laid down in s.90 FSMA.

[1361] Note that the Transparency Directive only provides for periodic disclosure obligations and does not deal with the ad hoc disclosure regime that is instead contained in the Market Abuse Directive. The latter does not impose any obligation as to liability rules comparable to the Prospectus and Transparency Directive. See on this topic for another opinion: HELLGARDT, 'Europarechtliche Vorgaben', 154-168.

[1362] ECJ, 7 September 2006, C-526/04, *Laboratoires Boiron SA* v *Union de recouvrement des cotisations de sécurité sociale et d'allocations familiales (Urssaf) de Lyon* [2006] ECR I-7529, para. 55. See also *infra*. Part I, Chapter II, para. 91 ff; and Part III, Chapter I, para. 330.

[1363] HELLGARDT, 'Europarechtliche Vorgaben', 161-162, 165. See on this topic also: VEIL (ed.), *European capital markets law*, 266, para. 67; MÖLLERS, 'Investor protection', 76-77. *Comp*.: DE JONG, 'Liability for Misrepresentation', 353.

[1364] ALCOCK, 'Misinforming the market', 243.

[1365] The loss of a chance doctrine was criticized for a lack of transparency in the calculation of the damages, based on an assessment of the chance that has been lost on the investors as a result of the deficient market disclosures. The approach was also found to violate the principle that the loss should be assessed as accurate as possible and criticized for being applied very frequently and very leniently, resulting a generous and (too) investor friendly system. See for this criticism: *supra*, para. 355 and the references cited in ftn. 1276. Alternatively, approaches allowing for leniency based on the risk profile and sophistication of investors were criticized for being inconsistent and wrong (see *supra*, para. 342).

2. Differentiated liability regimes for periodic and ad hoc disclosure obligations?

382. Although the Market Abuse Directive does not contain an express obligation to provide for liability rules remedying losses incurred following contraventions of ad hoc disclosure rules (nor the future Market Abuse Regulation), the question inevitably arises whether liability for ad hoc disclosures, and rules facilitating the causation requirement in particular, should be reconsidered too.[1366] The inclusion of ad hoc information in an adjusted secondary market information liability regime would, however, not follow from EU law obligations, but rather draw on general concerns regarding the practicality efficiency and effectiveness of such a regime. More particularly, in case facilitations would be introduced with regard to periodic reporting obligations based on art. 7 Transparency Directive, but no such facilitations would apply to ad hoc disclosures as regulated in the Market Abuse Directive, differing liability regimes would be established depending on whether misleading information has been disclosed as an ad hoc announcement or in periodic reports. As a two-fold liability regime for continuous disclosure is likely to add to the complex puzzle of differing liability rules already, such system would obviously undermine the overall efficiency of the disclosure regime and offer a window for regulatory arbitrage. In an attempt to limit liability and litigation risks, issuers may for instance be induced to disclose as much as possible through ad hoc disclosures instead of periodic information reports. Moreover, the lines between ad hoc and periodic disclosures may sometimes be blurred since some ad hoc disclosures might also require inclusion in periodic reports, with the confusing result that liability rules for the second type of disclosure differ from claims filed based on the first disclosure, notwithstanding it concerns the same information.[1367] In short, for the sake of overall transparency and minimal complexity of the system, a similar approach to liability for breaches of periodic and hoc disclosure rules is advocated, especially since clear and convincing justifications for differentiated liability regimes depending on whether it concerns periodic or ad hoc disclosures are lacking.[1368]

IV. Assessment and concluding remarks

383. This chapter examined the requirements of causation and recoverable loss in the context of investor claims following deficient issuer disclosures. The analysis shows that courts have adopted an approach highly similar to investment services litigation. As was the case in investment services, causation is evaluated through the two-pronged approach, which requires that both the investment decision to buy, hold or sell has been affected by the erroneous information or would have been different in case the omitted or delayed information had been timely disclosed. Similar to precontractual information obligations imposed on financial advisors and asset managers, courts thus assume that issuer disclosure obligations should eliminate information asymmetries and enable the

[1366] *But: s*ee however: HELLGARDT, 'Europarechtliche Vorgaben', 154-168.

[1367] DAVIES, 'Davies review. Discussion paper', para 22. The UK legislator decided to include liability for misleading ad hoc disclosures in s.90A FSMA especially because of these considerations. See also *supra*: Part I, Chapter III, para. 187.

[1368] The issue has been discussed in Germany for instance, since differentiated liability regimes apply depending on whether it concerns ad hoc disclosures or periodic reporting. Against all odds, the German legislator introduced a special liability regime with regard to ad hoc disclosures (§§ 37 b, c WpHG) even though no obligations of that kind are imposed by the MAD, whereas no special, tailored statutory liability rules were introduced following the Transparency Directive. As a result, ad hoc liability is governed by the rules laid down in §§ 37b, c WpHG whereas liability for periodic disclosure is governed by general liability rules, and §823 Abs. 2 BGB and §400 AktG in particular. The differentiated liability regimes depending on the type of disclosure have been the subject of criticism in the literature: SETHE in H.D. ASSMANN and U.H. SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, Köln, Verlag Dr. Otto Schmidt, 2009, §§37b, c WpHG, para. 28-30; MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 74; HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para.226.

investor public to make informed decisions As such, reliance is invariably at the center in the assessment of causation in this kind of litigation, as was the case with investment services litigation.

384. Due to its subjective nature and the evidential difficulties, the requirement of reliance has however proven to be a barrier to investors trying to obtain compensation for losses suffered as a result of misleading market disclosures. Investors only rarely succeed in presenting sufficient factual evidence, causing courts and legislators to intervene and provide for facilitations. These facilitations are highly similar to those applied in financial services litigation and either comprise evidential facilitations (e.g. causal presumptions) or alternative concepts of loss and causation (e.g. the loss of a chance doctrine). Many of these facilitations, and most notably causal presumptions, were only provided for in the context of prospectus liability, however, and do not apply to secondary market information, which are still governed by general liability rules as regards causation and loss. The different approach has been justified by the difference in purpose and impact of the disclosures on the investor public and fear for unlimited liability and vexatious litigation. As a result, the evidential problems with regard to causation in the context of misleading secondary market information have remained mostly unaffected, causing courts to deal by looking for indications and criteria that might support the probability of reliance or lack thereof. French courts resorted to the loss of a chance doctrine (both with regard to prospectus and ongoing disclosures), while other courts considered (short) lapses of time between the disclosures and the transactions as clear indications of reliance, or classified investors based on their profile in order to derive the likeliness of reliance based on the type of investor. These solutions have been employed with varying degrees of success. The classification of investors proved an imperfect solution because the courts still found themselves faced with highly subjective assessments that prove unworkable in large scale investor litigation. With regard to the French approach, criticism has been raised that this results in an overly investor-friendly regime inducing frivolous claims and arbitrary assessments of loss. The German approach on the other hand proved to render investor claims nearly unenforceable for private parties, as illustrated by the *Neuer Markt* controversy.[1369] Overall, these approaches do not offer sound, consistent solutions to the problem of reliance with regard to secondary market information. The real problem underlying the inadequacy of these solutions and the transaction model in this context more generally, however, is not the evidential problem, but rather the observation that (retail) investors ordinarily do not read or scrutinize all available information in order to make informed investment decisions, while even if investors are aware of ongoing market disclosures, these disclosures are often only one of the many elements that are taken into account when making investment decisions.

385. A second conclusion concerns the concept of loss applied in this framework. Once again courts seem to struggle with the concept of recoverable loss in the context of deficient market disclosures. Again, the questions center around the question how to compensate investors without violating the principle that risks inherent to investments should be borne by investors and should not be shifted to issuers. Rescissory remedies are however often claimed and granted regardless of whether it concerns prospectus liability or secondary market liability cases. As was the case in the context of investment services litigation however, this measure of damages should be applied with caution. The possibility to obtain rescissory damages allows investors to obtain compensation for losses suffered as a result of factors unrelated to the fraud, which may have been suffered when other

[1369] HELLGARDT, 'Europarechtliche Vorgaben', 160; FERRAN, *Building an EU securities market*, 245-246. See for a similar conclusion: CASPER, 'Significance of the Law of Tort', 98-99; HELLGARDT, *Kapitalmarktdeliktsrecht*, 518; WAGNER, 'Schadensberechnung', 505.

investments were chosen instead. The rescissory measure hence provides investors with a very broad protection, including protection against price declines due to exogenous factors and risks which are in essence to be borne by the investors themselves. Given this broad scope of rescissory damages, it should not come as a surprise that courts apply caution and restraint in awarding damages following deficient information. Especially when it comes to secondary market information, courts and literature have acknowledged that single ad hoc announcements or periodic disclosures such as annual reports are often not consulted by (retail) investors and hence fail to impact the investment decisions of these investors. As a result, investor claims following violations of continuous disclosure obligations are rarely granted. The rather low chances to prevail in this kind of litigation along with the fact that considerable costs may be generated whereas the loss suffered may be fairly limited for retail investors, also explains why this kind of litigation is very rarely reported and fairly undeveloped in various Member States. In the rather rare cases in which investors prevail, however, rescissory damages restore investors to the position they were in before they entered the transaction occurred and also offer courts a very easy and straightforward method to award damages, relieved from complications related to contemporaneous and intervening factors that affected the securities price, yet are unrelated to the misrepresentation as such.

386. Considering the application of rescissory damages in secondary market liability, commentators in various Member States have pointed out that compensating investors for their total investment is too far-reaching and approximates some kind of investor insurance. As a result, solutions and alternatives have been advanced aimed at compensating investors for loss suffered due to misrepresentations, yet with a better allocation of investment risks. An example of such compromise between compensation and risk allocation can be found in US prospectus liability rules and is generally referred to as the modified rescissory damages. The system implies that investors are entitled to restitution if they still possess the securities at matter, or alternatively damages equal to the difference between the purchase price and the price for which the securities have been sold.[1370] If and to the extent the defendant proves that (part of) the price decline is unrelated to the misrepresentation however, (that part of) the loss is deemed unrecoverable. It was pointed out however that his approach is not entirely compatible with the transaction based-approach since it does not restore investors to the position they were in had they not entered into the transaction, as was also opinioned by the German Supreme Court and the prevailing opinion in Germany.[1371]

387. Alternatively, one may preclude the investor from recovering losses that are unrelated to the misrepresentation at matter by employing the comparative method that compares the (hypothetical) alternative investment the investor would have made with the actual situation to distinguish between recoverable and irrecoverable losses. This solution was suggested in the context of financial services litigation, as discussed in one of the previous chapters, and has also been advanced in the German literature, yet it was stressed that this method is often hard or even impossible to apply in the context of losses suffered following wrongful issuer disclosure as it is often impossible to determine what alternative investment would have been chosen but for the fraud, and might lead to arbitrary results.[1372]

[1370] See *supra*: ftn. 1300.

[1371] The assumption that another investment decision would have been taken but for the misrepresentation underlies the concept of reliance in investor litigation and thus leads more or less automatically to rescissory damages as a result. HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 184, with references cited, including BGH, 5 July 1993, II ZR 194/92, *BB* 1993, 2108.

[1372] ARONS and PIJLS note that the courts should primarily take the past investment experience into account to determine whether or not the investor would have chosen an equally risky investment or whether he is the type to choose a more

As a solution to this problem, it was suggested to correct investor compensation based on the rescissory measure by deducting that (part of) the price decline that is proven to be unrelated to the misrepresentation, and therefore unrecoverable.[1373]

388. Yet another technique to separate losses incurred as a result of general market risks unrelated to the actual misrepresentations is the loss of a chance-doctrine, as applied in France. Pursuant to its decision in *Gaudriot*, the French Supreme Court held that as a matter of principle, losses suffered following erroneous disclosures deprive investors of the chance to decide on an informed basis whether to sell, purchase or retain securities. The loss suffered as a result of the misreporting is therefore considered the loss of a chance. Regarding the assessment of the loss, this implies that the investors have been deprived of the chance to avoid the occurrence of the injury. Since risks are inherent to investments in financial instruments (‘*l’aléa boursier*’), the damages must be determined accordingly and cannot equal the total of the loss suffered by the aggrieved investor, according to established case law. This technique has been seriously criticized, however, for being a lump-sum approach serving as a patch up to circumvent complex questions that arise in assessing causation and loss, resulting in arbitrary court decisions. For these reasons, the loss of a chance-doctrine does not seem to offer an appriopriate and sound solution.

389. A fourth and final possible approach implies the measurement of loss in terms of the price difference caused by misinformation while excluding those changes in price that were caused by factors other than the misinformation. This method involves the analysis of how the misrepresentations impacted the price formation of the securities and compensates investors for the difference in price and has been particularly – though not exclusively –gaining ground in Germany.[1374] This method differs not so much in outcome from the US system applied under s.11 and s.12 Securities Act in terms of its outcome, yet at the same time it is fundamentally different in model as it no longer assumes that investors would not have invested but for the misrepresentation, but instead assumes that investors would have purchased the securities anyway but for another price. This model and its implications are discussed in detail in the next chapter.

390. A final remark concerns the question whether the liability rules satisfy the European requirements and principles, as set out in the first chapter of this thesis. Whereas no particular European requirements apply with regard to civil liability rules for deficient ad hoc disclosures, such obligation does exist with regard to periodic disclosures following art. 7 Transparency Directive. However, if investors are required to present evidence of their individual reliance on the information when deciding to trade without any flexibility as to the evidential rules or lowering of the burden of proof, this is a very high threshold to meet, as the series of decisions in the German *Neuer Markt*-litigation demonstrated. As a result, it may be doubted whether such requirement meets the standards set by EU law, and the principle of effectiveness in particular.

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conservative kind of investment, whether the investor-claimant is likely to follow market trends (and potentially hypes or bubbles it can hence be assumed). ARONS and PIJLS, ‘Prospectus liability in the Netherlands', 479-480. Similar: DE JONG, Aansprakelijkheid, 579.

[1373] *Supra* para. 363.

[1374] (The Netherlands) ARONS and PIJLS, ‘Prospectus liability in the Netherlands', 472 ff.. Similar: DE JONG, Aansprakelijkheid, 523. (Belgium) VANDENDRIESSCHE, 'Fraud-on-the-market', 277. See the next chapter for more details.

CHAPTER II. AN ALTERNATIVE APPROACH TO INVESTOR LOSSES FOLLOWING SECONDARY MARKET MISSTATEMENTS: THE MARKET-BASED APPROACH

391. Focus on market integrity secondary market trading. – This chapter aims to examine an alternative approach to causation and loss as applied in investor suits following deficient issuer disclosures. Rather than focusing on the distortion of investment decisions pursuant to wrongful information, this alternative model is based on the impact wrongful disclosures may have on securities prices, causing investors to trade against manipulated prices and suffer losses as a result of price manipulation. This chapter predominantly discusses the interaction between issuer information and prices in the context of secondary market trading and ongoing disclosure. Even though this alternative model may also be relevant in the context of prospectus liability, it is noted that there are relevant differences between the pricing mechanisms of securities traded on secondary markets and securities that are newly offered.[1375] A second reason to distinguish between prospectus liability and liability pursuant to misleading continuous reporting concerns the fact that prospectus liability has been regulated in various Member States, raising the question whether and how this alternative model may fit into the regulatory liability regimes. Liability for misleading continuous reporting on the other hand is mostly governed by general civil liability rules, especially with regard to causation, loss and the assessment of damages. The previous chapter already pointed out that the statutory liability regimes have facilitated the compensation of investor losses following misleading prospectuses, yet no such facilitations generally apply with regard to liability for ongoing disclosures. This chapter therefore predominantly discusses the application of this alternative model with regard to ongoing secondary market information, whereas its application to prospectus liability claims is discussed under a separate heading.[1376] As the model advanced in this chapter focuses on market integrity rather than individual investor protection, it is generally referred to as the market model or market-based approach, in contrast with the transaction model or transaction based-approach discussed in the previous chapters.[1377]

I. The market model: protection of market integrity

A. The market model: conceptual underpinnings

392. Critical assumptions underlying disclosure obligations. – As demonstrated in the previous chapters, courts have traditionally and predominantly approached causation in the context of investor losses through a reliance-centered perspective, regardless of whether it concerns liability following defective investment services or deficient issuer disclosure. This perspective clearly draws on the rationale underlying market disclosure and information obligations, being the elimination of information asymmetries between (retail) investors and their (professional) counterparts, and

[1375] See *infra* para. 489

[1376] Idem.

[1377] See also *supra*, Part III, Chapter I. The term 'market model' was used by FISCHEL to contrast the traditional approach towards investment decisions with the alternative model advanced in an acclaimed publication, termed 'the market model of the investment decision'. FISCHEL, 'Use of Modern Finance, 3.

consequently, the enhancement of investor protection.[1378] From this perspective, market disclosures are generally aimed at enabling individual investors to make informed investment decisions.

Capital market disclosure is however not exclusively aimed at the empowerment of investors, but also plays an important role in terms of the formation of securities prices, market integrity and the overall efficient functioning of markets.[1379] More particularly, whereas common (consumer) goods have a certain value as utensil, the value of a security corresponds to the expected future dividends or cash flows to shareholders. Corporate finance theory holds that, under certain circumstances, the expectations regarding the dividends and cash flows are based on information available to the market and have a direct impact on the valuation of those securities by market participants, who decide whether to trade or not depending on their valuation of the security.[1380] To the extent they consider securities overpriced in the light of the information they have access to, they will sell or not purchase the securities, whereas they will acquire securities when they consider the price of those securities below their own estimation.[1381] As securities prices depend on supply and demand, the price will adjust to the transactions effectuated by these informed traders and determine the prices against which uninformed investors are trading too.[1382]

The fact that the present value of a security relates to information, and expectations based on that information, explains and justifies why disclosure of price-sensitive information is strictly regulated.[1383] Through disclosing unwarranted information or omitting material information, securities prices may be manipulated, causing investors to trade against inflated or deflated prices.[1384] As investors may suffer losses as a result of such price manipulation, they may lose confidence in the market and abstain from trading or demand risk premiums which increases the costs of capital and strains liquidity.[1385] Costs of trading will also increase as the unreliability of market disclosures will

[1378] See also *supra*, Part I, Chapter I, para. 13.

[1379] Rec. (2), (11), (12), (15), (24) Preamble Market Abuse Directive; Rec. (1) Preamble Transparency Directive. The interaction between securities pricing and market disclosures has been most extensively discussed in (US) finance literature and has led to the genesis of the efficient capital market hypothesis, which is discussed further below. On the interaction between information and securities prices and the role of securities regulation (including disclosure rules), see: GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 711.

[1380] J.W. EISENHOFER, G.C. JARVIS and J.R. BANKO, 'Securities Fraud, Stock Price Valuation, and Loss Causation: Toward a Corporate Finance-Based Theory of Loss Causation', 59 *Bus. Law.*, 2004, 1419; C. LEE, J. MYERS and B. SWAMINATHAN, 'What is the intrinsic value of the Dow', 54 *Journ. Fin.*, 1999, iss. 5, 1693; M.A. ERDLEN, 'Timing is everything: Markets, Loss, and Proof of Causation in Fraud on the Market Actions', 80 *Fordham L. Rev.*, 2011, iss. 2, 890; EISENHOFER, JARVIS and BANKO, 'Securities Fraud', 1421 ff.; J.E. FISCH, 'Cause for Concern: Causation and Federal Securities Fraud', 94 *Iowa L. Rev.*, 2009, 854; M.A. OLAZÀBAL, ‘Loss causation in Fraud-on-the-Market cases Post-Dura Pharmaceuticals’, 3 *Berkeley Bus. L.J.*, 2006, 367; S. BHAGAT and R. ROMANO, 'Event Studies and the Law: Part I: Technique and Corporate Litigation', 4 *Am. L. & Econ. Rev.*, 2002, iss. 1, 141; D. TABAK and C. OKONGWU, 'Inflation Methodologies in Securities Fraud Cases: Theory and Practice', 2002, NERA working paper, available at: http://www.nera.com, 2.

[1381] FISCHEL, 'Use of Modern Finance', 4.

[1382] Informed traders are those investors who trade on an informed basis, in line with what the transaction model prescribes. See on the role of informed traders also: GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 711; FISCHEL, 'Use of Modern Finance', 4.

[1383] See also: HELLGARDT, *Kapitalmarktdeliktsrecht*, 520; T.M.J. MÖLLERS, 'Efficiency as a standard in capital market law - The application of empirical and economic arguments for the justification of civil law, criminal law and administrative law sanctions', *EBLR* 2009, 247; T. WEICHERT, *Der Anlegerschaden bei fehlerhafter Kapitalmarktpublizität*, Baden-Baden, Nomos, 2008, 98 ff.

[1384] Rec. (15) and (24) Preamble MAD. See also: HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §15, para. 10; ZIMMER/KRUSE in SCHWARK and ZIMMER, *Kapitalmarktrechtskommentar*, §15 WpHG, para. 8; HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §37b, c WpHG, para. 7; ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §15, para. 32 ff.

[1385] See for instance: AKERLOF, 'The market for lemons', 488, asserting that information asymmetries with regard to the products offered in a market render it impossible for buyers to distinguish between high quality products and low quality cause investors to do more research themselves, process more information and make more analyses in order to remain informed, while issuers will spend more resources on efforts to convince the market of the reliability and credibility of their disclosures.[1386] Manipulation of securities prices is also harmful in terms of allocative efficiency because investors can no longer distinguish the most valuable investment projects and may be directed towards relatively inferior projects.[1387] Hence, market integrity is deemed key to investor confidence, liquidity, accurate pricing and allocative efficiency.[1388] As a result, (mandatory) issuer disclosures do not solely protect investors from information asymmetries, but also protect investors from trading against manipulated transactions.[1389]

B. Causation and loss following misleading disclosures in the light of the market model

393. The impact of information on the price building process of securities offers an alternative perspective on causation and recoverable loss as its implications for loss and causation are radically different from those under the traditional transaction model.[1390] Whereas causation is interpreted as the link between misleading or non-disclosed information and distorted investment decisions in the traditional transaction model, causation in the market model concerns the link between inaccurate disclosures and price distortion in the market model. As a result, the recoverable loss depends on the impact of the wrongful disclosure on the price and differs from the traditional transaction model that considers the recoverable loss in the light of the different outcome of a different investment decision that would have been made absent the wrongful disclosure. Hence, it is no longer required that the investor has read the information, nor that he understood or processed the information and relied on it in making his decision. Instead, the requirement of causation is met as soon as an investor traded against a distorted price as a result of misrepresentations or omissions.

394. These insights on the link between price manipulation and market disclosure obligations are far from new and have been the subject of extensive scholarly writing in the US decades ago.[1391] Unlike the EU Member States, these insights were incorporated in the liability rules quite early and

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products. As a result, because of fear for being exploited, buyers will be less willing to buy products and apply a discount on the price to compensate the risk they are buying a low quality product.

[1386] FAMA and LAFFER, 'Information and capital markets', 289 on the value of public information and effective allocation on capital markets. And: EASTERBROOK and FISCHEL, 'Mandatory disclosure', 674. For an overview of relevant literature, see also: VEIL (ed.), *European capital markets law*, 215. These arguments and insights are also mentioned in A.D. EVANS, 'Investor Compensation Fund', 33 *J. Corp. L.*, 2007-2008, 228; SPITZ, *La réparation*, 78, para. 112.

[1387] See the references cited in the two previous ftns. See also: FISCHEL, 'Use of Modern Finance', 16. And: *supra*, Part. I, Chapter I, para. 13.

[1388] EASTERBROOK and FISCHEL, 'Optimal damages', 613.

[1389] The function and added value of mandatory disclosures has been discussed and researched for a long time already under impulse of a strand in literature asserting that in absence of mandatory rules, relevant information would still be voluntarily disclosed as a result of the private incentives issuers have to do so. It has been argued in this regard that when left to the market, a more efficient disclosure system would emerge as issuers would only disclose information when the benefit of doing so would outweigh the cost, which is arguably not the case in systems of mandatory literature. See for this strand of literature: EASTERBROOK and FISCHEL, 'Mandatory disclosure', (669) 693; KRIPKE, 'A search for a Meaningful Securities Disclosure Policy', 293. Others have rejected this approach asserting that market failures would undermine the system or advancing arguments based on the value of information as a 'public good', rather than only weighing the private costs and benefits for individual issuers. See in this regard especially: J. C. COFFEE, 'Market Failure and the Economic Case for a Mandatory Disclosure System', 70 *Va. L. Rev.*, 1984, 717.

[1390] Numerous publications in the US have discussed this shift from transaction based-approach towards market based-approach. One of the most influential contributions in this regard has been written by FISCHEL: FISCHEL, 'Use of Modern Finance', 1.

[1391] *Ibid.*,1. See in this regard – amongst others – also: GILSON and KRAAKMAN, 'The mechanisms of market efficiency', 549; GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 711.

have remained the subject of (vast) academic writing ever since.[1392] As observed in the previous chapter, the possibility to approach causation and loss through the market model in EU Member States is gaining ground, although its impact so far has mostly been confined to the literature, except for Germany where the alternative approach is also visible in the case law.[1393] The implications, advantages and difficulties of the market model are explored in this chapter and considered from the perspective of the current national legal frameworks applicable to liability for erroneous ongoing disclosures, aided by the insights offered through a comparative review of how the alternative approach has been applied in the US.

II. Origin of the market-based approach: the efficient capital market hypothesis and the genesis of the US fraud on the market-theory

A. Overview

395. As in the UK common law, US courts modeled securities fraud liability traditionally to the common law torts of deceit and misrepresentation.[1394] As a result, reliance was an essential component of liability claims in the US too, causing a serious hurdle to investor-claimants to obtain compensation in court in two respects. The first problem concerned the evidential problem related to the reliance-approach, as extensively discussed in the previous chapter. The second problem relates to the US practice to collectively litigate this kind of claims (by means of class actions) and the hurdle the reliance requirement poses in this regard. More particularly, because losses suffered by individual investors are generally too small to start a procedure and bear the costs associated with it, class actions

[1392] The literature on causation in securities fraud litigation in the US is immense. Amongst others, consult for instance: D.C. LANGEVOORT, 'Basic at twenty: rethinking fraud-on-the-market', *Wis. L. Rev.*, 2009, 151; N.L. GEORGAKOPOULOS, 'Frauds, markets, and fraud-on-the-market: the tortured transition of justifiable reliance from deceit to securities fraud', 49 *U. Miami L. Rev.*, 1995, 671; GILSON and KRAAKMAN, 'The mechanisms of market efficiency', 549; GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 711; W.W. BRATTON and M.L. WACHTER, 'The political economy of fraud on the market', 160 *U. Pa. L. Rev.*, 2011, 69; J. C. COFFEE, 'Causation by presumption? Why the Supreme Court should reject phantom losses and reverse Broudo', 60 *Bus. Law.*, 2005, 533; M.B. FOX, 'After Dura: Causation in Fraud-on-the-Market Actions', 31 *J. Corp. L.*, 2006, 829; L.B. LOCKWOOD, 'The Fraud-on-the-market theory: a contrarian view', *Emory L. J.*, 1989, 1629; J.R. MACEY and G.P. MILLER, 'Good finance, bad economics: an analysis of the Fraud-on-the-market theory', 42 *Stan. L. Rev.*, 1990, 1059; ERDLEN, 'Timing is everything', 877; OLAZÀBAL, 'Loss causation', 337; J.L. OLDHAM, 'Taking 'Efficient Markets' Out of the 'Fraud-On-The-Market' Doctrine After the Private Securities Litigation Reform Act', 97 *Nw. U. L. Rev.*, 2003, 995; FISCH, 'Trouble with Basic', 895.

[1393] See also: (Belgium) VANDENDRIESSCHE, 'Fraud-on-the-market', 277; RAVELINGIEN, Privaatrechtelijke handhaving, 812. (Germany) The German literature is extensive in this regard, see amongst others for instance: MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§ 37b, c, para. 244; HELLGARDT, *Kapitalmarktdeliktsrecht*, 519, and 521-522 in particular; WAGNER, 'Schadensberechnung', 520; RICHTER, *Schadenszurechnung*, 95 ff.; SETHE in ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §§37b, c, 1630, para. 72. With regard to the case law and the position of the BGH in this regard, see further below: *infra* para. 417 ff. (The Netherlands) M.M. MENDEL, 'De Fraud on the Market-theorie', X., *Quod Licet (Kleijn bundel)*, Deventer, Kluwer, 1992, 245; DE JONG, *Schade door misleiding*, 154 ff; PIJLS, 'Informatieverzuimen', 170. (France) SPITZ, *La réparation*, 212; (Austria) SCHOBEL and PARZMAYR, 'Anlegerschaden und Schadensberechnung', 165. With regard to the German case law and the IKB-decision in particular, see *supra* Part. III, Chapter I, para. 364. See also *infra*, para. 419.

[1394] The common law influence on rule 10b-5 is for instance explicitly referred to in the US Supreme Court decision in Dura Pharmaceuticals: "Given the common-law roots of the securities fraud action […]" and: "Judicially implied private securities-fraud actions resemble in many (but not all) respects common-law deceit and misrepresentation actions", Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 343 (the latter cited in: Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 744 (1975)); "*Rule 10b-5 is "essentially a tort claim*", Moody v. Bach & Co., 570 F.2d 527 (5th Cir. 1978). See also: ERDLEN, 'Timing is everything', 879 and references cited; see also: J.C.P. GOLDBERG, A.J. SEBOK and B.C. ZIPURSKY, 'The place of reliance in fraud', 48 *Ariz. L. Rev.*, 2006, 1004 ff.; GEORGAKOPOULOS, 'Frauds, markets, and fraud-on-the-market', 671-730; LANGEVOORT, 'Basic at twenty', 7. See on the courts' tendency to fit rule 10b-5 into the traditional common law framework also: E.C. BURCH, 'Reassessing damages in securities fraud class actions', 66 *Md. L. Rev.*, 2007, 350. Extensively on the interaction between the common law tort of fraud and the application of the securities fraud regulation by the US courts: N.S. POSER, 'Securities Fraud and the common law', 1 *Journal of Securities & Futures Law*, 2008, no. 2 3.

are often the only reasonable means for (alleged) aggrieved investors to obtain compensation.[1395] In order to be granted, class actions require that “the questions over law and fact common to the member of the class predominate over any questions affecting individual members”.[1396] If every single class member is to show that he or she relied on the erroneous information disclosed in order for the collective procedure to be allowed, the chances of success are evidently very low to inexistent, particularly in the light of the evidential issues attached to the reliance requirement.[1397] In its search for an alternative approach that would alleviate the aforementioned problems, the literature and lower courts resorted to the then surging financial-economic theory on efficient capital markets to explain the impact of information on stock prices. Since the theory has been pivotal to the development of the alternative approach to causation in securities fraud cases, a brief overview is presented below.

B. Financial-economic theory: the efficient capital market hypothesis

396. Concept and theoretical underpinnings. – The efficient capital market hypothesis (hereinafter “ECMH”) was developed in the US financial and economic scholarly literature and asserts that in an efficient market all relevant information with respect to the securities traded is (almost instantaneously) reflected in its price.[1398] The mechanism underlying this theory can be briefly explained as follows. As soon as information gets disclosed to the market it is picked up by financial analysts in recommendations, opinions and advices. This information includes economic reports and prognoses, reports and statements disclosed by issuers and professionals, press releases etc. Analysts’ recommendations are closely followed and examined by a limited group of professional investors and market participants, such as institutional investors, investment banks and commercial banks, securities brokers and dealers, investment funds and the like.[1399] These informed investors react to the available information by trading securities they deem under- or overvalued on the market in the light of the available information.[1400] This in turn affects supply and demand of securities, and consequently impacts the stock prices. Price movements in stock prices again evoke certain reactions on the market by investors noting these price evolutions, which may again result in price fluctuations. Professional investors will incessantly locate securities that they consider mispriced compared to their own valuations based on the information they have access to. As a result of this trading process in response to new information, securities prices traded in efficient markets reflect all available information about a particular issuer’s prospects, according to ECMH.[1401] In an orthodox understanding of the ECMH, the price of frequently traded securities on an efficient market should be equal to its intrinsic value (fundamental efficiency).[1402] Drawing from the premise that securities trading on efficient markets

[1395] See for instance US Supreme court decision: Eisen v. Carlisle & Jacquelin, 417 US 156 (1974), in which it is noted that “[e]conomic reality dictates that petitioner's suit proceed as a class action or not at all.” (at 161).

[1396] Rule 23(b) (3) US Federal Rules of Civil Procedure. See more extensively: M. PALMISCIANO, 'Going Dutch: The Effects of Domestic Restriction and Foreign Acceptance of Class Litigation on American Securities Fraud Plaintiffs', 53 *B. C. L. Rev.*, 2012, 1850 ff.; ERDLEN, 'Timing is everything', 892.

[1397] “While reliance is typically demonstrated on an individual basis, the Supreme Court has noted that such a rule would effectively foreclose securities fraud class actions because individual questions of reliance would inevitably overwhelm the common ones under Rule 23(b)(3)”, Basic Inc. v. Levinson, 485 U.S. 224, at 242.

[1398] FAMA, 'Efficient capital markets', 383-417; GORDON and KORNHAUSER, 'Efficient markets', 834; GILSON and KRAAKMAN, ‘The mechanisms of market efficiency’, 549-644.

[1399] See also: GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 723 ff. The authors use the term ‘information traders’ for this group of sophisticated professional traders and analysts.

[1400] FISCHEL, 'Use of Modern Finance', 4.

[1401] FAMA, 'Efficient capital markets', 383; FISCHEL, 'Use of Modern Finance', 4.

reflect the available information, courts and literature in the US developed the fraud on the market-doctrine, marking a new approach to causation and recoverable loss in the context of misleading disclosures. It is noted from the outset that even though the ECMH has been challenged over time (see further below), the fraud on the market-doctrine has persisted.

C. The development of the US fraud on the market-doctrine

397. Confronted with evidential problems related to the requirement of reliance and the need to develop an approach that would offer the means to deal with securities fraud mass claims in a more efficient manner, US courts developed an alternative approach to causation and damages based on the then widely accepted ECMH.[1403] Drawing from the insight that when trading on an efficient market, securities prices reflect all available information it logically follows that misleading information is reflected in the price as well. Investors trading securities affected by incomplete or incorrect information are thus trading for inflated or deflated prices which may cause them to suffer losses to the extent they buy for a price too high or sell for a price too low, regardless of whether they actually read or heard the misleading information themselves.[1404] Instead of relying on disclosed information in order to make investment decisions, investors rather rely on the correctness of the price and market integrity in general. The insight that the investor public can be *indirectly* misled by deficient issuer information through reliance on the integrity of the market and securities prices fueled one the most important evolutions in US securities fraud litigation as it caused the US Supreme Court to endorse the ECMH and introduce the fraud on the market-doctrine (FOM).

1. Rule 10b-5: context and background

398. Rule 10b-5. – In the US, investor litigation for erroneous market disclosures is based on Rule 10b-5.[1405] Rule 10b-5 was promulgated by the Securities and Exchange Commission (hereinafter:

[1402] This statement though is not an exclusive premise of the ECMH, but is also tied to the *capital asset pricing model* (hereinafter: "CAPM"). CAPM is based on the assumption that parties value securities according to two factors, being on the one hand the expected future return and on the other hand, the expected risks. CAPM assumes a linear correlation between those two elements, being a positive assessment of the expected return and a negative on the expected risks. As a result, the risks will increase proportionally to the increase in return. To the extent the risks increase disproportionally to the relative return, the security will be attributed with a lower value. Combining ECMH and CAPM leads to the result that the risk and return of securities traded on efficient markets are equal. Or put differently, the prices of those securities reflect their intrinsic or fundamental value. See in this regard also: LEE, MYERS and SWAMINATHAN, 'What is the intrinsic value of the Dow', 1693; ERDLEN, 'Timing is everything', 890; W.T. ALLEN, 'Securities markets as social products: the pretty efficient capital market hypothesis', 28 *J. Corp. L.*, 2003, 553; L. STOUT, 'The mechanisms of Market inefficiency: an introduction to the new finance', 28 *J. Corp. L.*, 2003, 641.

[1403] The US Supreme Court adopted the fraud on the market-theory in its pivotal decision Basic, Inc. v. Levinson, 485 U.S. 224, 232 (1988). For an overview see also: ERDLEN, 'Timing is everything', 894.

[1404] The concept of the recoverable loss in this model is discussed further below (see *infra* para. 427 ff.).

[1405] Codified in 17 CFR §240.10b–5. Since Rule 10b-5 does not explicitly provide in a private cause of action, it was up to the courts to determine whether or not Rule 10b-5 could be used as a legal basis for investor claims. The courts and especially the US Supreme Court's adoption of Rule 10b-5 as an appropriate private cause of action caused the rule to develop into one of the most important and frequently used regulation for private investor litigation. Or as US Supreme Court Justice William H. REHNQUIST put it: "When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn." (Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975)). The existence of an implied private right of action in Rule 10b-5 was confirmed in: Herman & McLean v. Huddleston, 459 U.S. 375, 380 (1983); Superintendent of Ins. of N.Y. v. bankers Life & Casualty Co., 404 U.S. 6, 13, n.9 (1971); Blue Chip v. Manor Drug Stores, 421 U.S., 723 (1975); Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977). See also: Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) *("*Judicial interpretation and application, legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation of Section 10(b) and Rule 10b-5, and constitutes an essential tool for enforcement of the 1934 Act's requirements.*"); Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983) (holding that the existence of an implied private right of action under section 10(b)*

"SEC") under section 10b of the Securities and Exchange Act 1934 ("SEA 1934").[1406] Rule 10b-5 implements the more general prohibition on market manipulation laid down in s.10b SEA 1934 and prohibits any act or omission resulting in fraud or deceit in connection with the purchase or sale of any security.[1407] Rule 10b-5 thus requires a misleading misrepresentation either by disclosing wrong information, or by the omission of material information. The deception must be effectuated by the issuer or persons entitled to speak in the latter's name. Additionally, a claim based on 10(b) and Rule 10b-5 also requires that the misrepresentation or omission was (1) material; (2) effectuated with scienter and (3) in connection with the purchase or sale of any security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.[1408]

399. Materiality and scienter. – Omissions or misrepresentations are considered material if a reasonable investor would have taken the information into account in making an investment decision.[1409] The concept 'material' is highly factual. As such, it has been refined and interpreted in numerous sets of circumstances and facts, forming a continuous development of the concept until today.[1410] Materiality essentially comes down to an abstract assessment of whether information is relevant to an average investor or the investor public in general. Contrary to reliance, it thus concerns an abstract assessment in which the concrete facts and circumstances of the individual investor-claimant are not taken into account. Scienter on the other hand implies the establishment of the defendant's awareness of committing fraud by the issuance of the deficient disclosure.[1411] Mere negligence does not suffice in other words, though courts have accepted that recklessness may satisfy the requirement of scienter.[1412] Even though the US securities laws, courts and scholarly literature

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*and rule 10b-5 is "*simply beyond peradventure*"*). See also extensively on this topic: J.D. GORDON III, 'Acorns and oaks: implied rights of action under the securities acts', 10 *Stan. L. Rev.*, 2004, 62-97; E.C. CHAFFEE, 'Beyond Blue Chip: Issuer standing to seek injunctive relief under section 10(b) and Rule 10b-5 without the purchase or sale of a security', 36 *Seton Hall L. Rev.*, 2006, 1135-1178.

1406 Section 10(b) SEA 1934 (15 U. S. C. §78j) is embedded in the US federal securities regulation and contains the prohibition to engage in market manipulation, as further defined and prescribed by the SEC. The SEC has exerted this power trough Rule 10b-5, which holds that it is unlawful to employ manipulative and deceptive devices as well as to make untrue statements or omit information relating to material facts. For the text of these rules, consult the included addenda at the end of this chapter.

1407 Rule 10b-5 has been included in the addenda further below.

1408 Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 157 (2008). Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005). See also: PALMITER, *Securities Regulation*, 365.

1409 Santa Fe Industries, Inc., v. Green, U.S. 462, 476-477 (1977); List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir. 1985). The US Supreme Court also considers a deception material in case "there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available" TSC Indus, Inc. v. Northway, Inc., 426 U.S. 449 (1976); Basic, Inc. v. Levinson, 485 U.S. 224, 232 (1988); recently confirmed in Matrixx Initiatives Inc. v. Siracusano, Dkt. No. 09-1156 (2011). See in this regard also: P.H. HUANG, 'Moody Investing and the Supreme Court: Rethinking the Materiality of Information and the Reasonableness of Investors', 13 *Sup. Ct. Econ. Rev.*, 2005, 99-131.

1410 In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410 (3d Cir. 1997); *Comp*: Semerenko v. Cendant Corp., 223 F.3d 165 (3d Cir. 2000); see also: United States v. Smith, 155 F.3d 1051 (9th Cir. 1998); and *comp.:* Isquith v. Middle South Utils., Inc. , 847 F.2d 186 (5th Cir. 1988). See in this regard also the recent US Supreme Court decision (March 22, 2011) in: Matrixx Initiatives Inc. v. Siracusano, Dkt. No. 09-1156 (2011).

1411 In *Ernst & Ernst v. Hochfelder*, the Supreme Court defined 'scienter' as "a mental state embracing intent to deceive, manipulate, or defraud". Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

1412 Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977); Alpern v. Utilicorp United, Inc., 84 F.3d 1525, 1534 (8th Cir. 1996); Provenz v. Miller, 102, F.3d 1478, 1490 (9th Cir. 1996); SEC v. Steadman, 967 F.2d, 636, 641-642 (D.C. Cir. 1992). See also: A. VASHISTA, D.R. JOHNSON and M.S. CHOUDHURY, 'Securities fraud', 42 *Am. Crim. L. Rev.*, 2005, (877) 885 and references cited. Note that with regard to recklessness no uniform standard is applied in the courts, as the court pointed out in *Tellabs, inc. v. Makor Issues & Rights, Ltd.*: "*Every Court of Appeal that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly, though the Circuits differ on the degree of recklessness required*." Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 n.3 (2007) (citing Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 338, 343 (4th Cir. 2003). The Private Securities invariably discuss securities *fraud* in the context of Rule 10b-5, violations of Rule 10b-5 do not necessarily amount to fraud in its traditional sense, i.e. the requirement to commit misconduct with a fraudulent intent. Securities fraud in the context of 10b-5, and by consequence in the remainder of this thesis, should therefore be understood as violations of the disclosure obligations, but not necessarily committed with fraudulent intent.

400. Purchase or sale of securities. – Pursuant to the requirement that the claim is connected with the purchase or sale of any security only the actual sale or purchase allegedly induced by deficient market disclosures can result in compensation. The mere holding or abstention to purchase them is not sufficient to file a claim.[1413] Besides material misstatements or omissions and the requirement to effect a transaction, the transaction must be carried out in reliance on the misstatement, according to the established case law of the US courts. In its pivotal decision in *Basic v. Levinson*, however, the US Supreme Court took the evolutions in finance theory with regard to the ECMH into account and introduced a new and innovative understanding of the concept of (transaction) causation in the context of Rule 10b-5.[1414]

2. Reliance in the context of Rule 10b-5

401. Similar to the EU Member States, US courts traditionally interpreted reliance as the requirement that an investor read and relied on deficient disclosures.[1415] The reason why the requirements of reliance and loss causation were adopted in the rule 10b-5 case law is the result of the assimilation of the private right of action based on this rule with traditional common law tort and negligence claims, which traditionally require reliance.[1416] As the US Supreme Court confirmed in *Basic v. Levinson* however, the context of a claim brought under rule 10b-5 differs considerably from those brought under traditional common law torts. Whereas traditional common law torts are used with regard to misrepresentation and deceit in face-to-face transactions, rule 10b-5 concerns securities transactions made in open markets.[1417] The difference is relevant because closed markets for goods are

Litigation Reform Act (1995) (PSLRA) has added that in order to file a claim, a plaintiff must succeed in establishing scienter with facts "giving rise to a strong interference that the defendant acted with the required state of mind". The US Supreme Court has interpreted the latter as requiring that scienter is more "than merely plausible or reasonable – it must be cogent and at least as compelling as any opposing inference of non-fraudulent intent". See with regard to the Private Securities Litigation Reform Act: 15 U.S.C. §78u-4(b)(2) (2000); with regard to the Supreme Court decision: Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S.Ct. 2499, 2504-05 (2007). See also: G.C. RAPP, 'Rewiring the DNA of Securities Fraud Litigation: Amgen's Missed Opportunity', 44 *Loy. U. Chi. L.J.*, 2013, 11, describing scienter as a midpoint in between negligence on the one hand, and intent on the other.

[1413] See *supra*: para. 334 and references cited in ftn. 1195.

[1414] Basic, Inc. v. Levinson, 485 U.S. 224.

[1415] List v. Fashion Park, Inc. 340 F.2d 457 (2d Cir. 1965); Schlick v. Penn-Dixie Cement Corp. 507 F.2d 374 (End Cir. 1974). For an overview, see also: FISCH, 'Cause for Concern', 816 ff.; OLAZÀBAL, 'Loss causation', 343.

[1416] RESTATEMENT (SECOND) OF TORTS §525 (1977) on fraud: "One who fraudulently makes a misrepresentation of fact, opinion, intention, or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation". The common law influence on rule 10b-5 is for instance explicitly referred to in the US Supreme Court decision in Dura Pharmaceuticals: "*Private securities fraud actions judicially implied under this section [§10(b)] have 'common-law roots*'" and: "*[...]resemble in many (but not all) respects common-law deceit and misrepresentation actions*.", Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 343 (the latter cited in: Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 744 (1975)); "Rule 10b-5 is "essentially a tort claim", Moody v. Bach & Co., 570 F.2d 527 (5th Cir. 1978). See also: ERDLEN, 'Timing is everything', 879 and references cited; see also: GOLDBERG, SEBOK and ZIPURSKY, 'The place of reliance in fraud', 1004 ff.; GEORGAKOPOULOS, 'Frauds, markets, and fraud-on-the-market', 671-730; LANGEVOORT, 'Basic at twenty', 7. See on the courts' tendency to fit rule 10b-5 into the traditional common law framework also: BURCH, 'Reassessing damages', 350 ff.

[1417] Basic, Inc. v. Levinson, 485 U.S. 224, at 244. See in this regard also: GEORGAKOPOULOS, 'Frauds, markets, and fraud-on-the-market', 676 ff.; FOX, 'After Dura', 831; FISCHEL, 'Use of Modern Finance', 13; BURCH, 'Reassessing damages', 350. See characterized by two parties being involved, being a seller and a buyer, who negotiate the terms and conditions of the sale. The seller is evidently the best informed party on the product and could (ab)use his advantage to deceive the buyer on the quality or other features of the product. If a seller takes advantage of information asymmetries, a buyer has the right to file claim for damages in order to repair his loss under the tort of deceit (in case of intentional wrong) or negligence. The claim will only succeed if the buyer reasonably relied on the information provided to him (reliance).

In an open, liquid secondary securities market however, the situation is different. The buyer is not dependent on the seller with regard to the determination of a correct price for the securities offered. Numerous buyers and sellers trade on securities exchange markets with anonymous counterparts. The value of a security is not determined by information buyer and seller exchange, but is instead determined by the market mechanism described in the ECMH. Contrary to what is the case in closed markets, there is no direct independence on the counterpart, but instead the parties rely on the stock price as an indicator of the value of the securities. To the extent the prices have been manipulated by erroneous information or wrongful omissions, investors are deceived as regards the correct price of the securities at matter. As a result, the traditional concept of reliance does not fit in with this particular securities fraud context. There is no need for the investors to read the erroneous information prior to trading, they are deceived regardless of having read the information due to paying an incorrect price for the securities, or selling against a manipulated price.[1418] Based on these insights, the US literature argued for a more appropriate interpretation of the concept of transaction causation in the context of rule 10b-5.[1419] The US Supreme Court responded to this evolution in its landmark decision in *Basic v. Levinson*.[1420]

3. Fraud on the market: the adoption of ECMH by the US Supreme Court

a. Fraud on the market as a presumption of reliance

402. ***Affiliated Ute Citizens of Utah v United States.*** – The first step in the adoption of an evolved causation concept was taken in the US Supreme Court decision in *Affiliated Ute Citizens of Utah v United States*, in which it was held that a presumption of reliance arises in cases involving an omission of a material fact by a party with a duty to disclose[1421]. The adoption of the presumption of reliance in this case was motivated by the consideration that a plaintiff faced a most difficult task establishing

on the difference between face to face-transactions vis-à-vis open market transactions also the opinion of Judge SNEED in Green v. Occidental Petroleum Corp. 541 F.2d 1335 (9th Cir. 1976) at 1341.

1418 "Because the rational course for investors is simply to accept (rely) on the market price, it is of no consequence whether a plaintiff can demonstrate that he relied upon a particular piece of information", FISCHEL, 'Use of Modern Finance', 8. See also Blackie v. Barrack, 524 F.2d 891, 907 (9th Cir. 1975), cert. denied, 429 U.S. 816 (1976), holding that "[h]ere, we eliminate the requirement that plaintiffs prove reliance directly in this context because the requirement imposes an unreasonable and irrelevant evidentiary burden. A purchaser on the stock exchanges may be either unaware of a specific false representation, or may not directly rely on it; […]. Nevertheless, he relies generally on the supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price whether he is aware of it or not, the price he pays reflects material misrepresentations."

1419 D. FISCHEL, 'Efficient capital markets, the crash, and the fraud on the market theory', 74 *Cornell L. Rev.*, 1989, 910.

1420 Basic, Inc. v. Levinson, 485 U.S. 224, 232 (1988). The US Supreme Court did not explicitly adopted fom in this decision, though allowed the lower courts to do so and confirmed this point of view in later cases. The FOM had been applied already in the lower courts' decisions as early as 1975 (by comparison: Basic, Inc. v. Levinson was decided in 1988), see *e.g.* Blackie v. Barrack, 524 F2d 891 (9th Cir 1975); see also: Lipton v. Documentation, Inc., 734 F2d 740 (11th Cir 1984); Peil v. Speiser, 806 F2d 1154 (3d Cir 1986).

1421 Affiliated Ute Citizens of Utah v United States, 406 U.S. 128 (1972). In this case, plaintiffs had sold stocks to the defendants for a price considerably below the market price, which was not known at the time of sale by the plaintiffs.

proof of his contention that he would not have sold had he been aware of all relevant information. Since *Affiliated Ute Citizens of Utah v United States* concerned a closed, face to face transaction between the plaintiffs and the bank-defendant, lower courts reacted in a confused and divided manner on the judgment. Some refused to extent the presumption to open market securities transactions, whereas others considered the presumption not applicable in case not an omission, but instead an erroneous disclosure had taken place. The general adoption and break-through of the presumption of reliance, articulated for the first time in *Ute* generally referred to as the fraud on the market-doctrine (hereinafter "FOM"), was established in *Basic v. Levinson.*[1422]

403. Fraud on the market-doctrine. – In *Basic v. Levinson*, the US Supreme Court confirmed that transaction causation in the context of rule 10b-5 claims is generally presumed based on considerations of judicial economy, fairness, public policy, probability and the congressional policy embodied in the securities acts.[1423] The court also acknowledges that "the modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases". According to the Supreme Court, the reliance requirement of rule 10b-5 should encompass this different context in the sense that different from face-to-face transactions, the market is interposed between the selling and buying party and transmits the information to the investor in the form of a market price.[1424] The court continues to state that a presumption of reliance is also supported by 'recent empirical studies' showing that market prices of shares traded on well-developed markets reflect all publicly available information including any material misrepresentations.[1425] In the light of these considerations, the court concludes that the reliance of individual plaintiffs on the integrity of the market price may be presumed.[1426]

404. Criticism on the use of a legal presumption of reliance. – It should be stressed that in order to fit FOM into the traditional common law framework, the court did not dispense of the requirement of reliance, but instead held that reliance is presumed.[1427]Although the presumption attempts to compromise between the court's inclination to adhere to the traditional common law framework on the one hand, and the aspiration to facilitate investor claims on the other, it fails to recognize that the

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[1422] Basic, Inc. v. Levinson, 485 U.S. 224 (1988).

[1423] *Ibid*., p. 245.

[1424] The US Supreme Court particularly held the following: "In face-to-face transactions, the inquiry into an investor's reliance upon information is into the subjective pricing of that information by that investor. With the presence of a market, the market is interposed between seller and buyer and, ideally, transmits information to the investor in the processed form of a market price. Thus the market is performing a substantial part of the valuation process performed by the investor in a face-to-face transaction. The market is acting as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price."(With reference to: In re LTV Securities Litigation, 88 F. R. D. 134, 143 (ND Tex. 1980)). Basic, Inc. v. Levinson, 485 U.S. 224, at 244.

[1425] "The presumption is also supported by common sense and probability. Recent empirical studies have tended to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." Basic, Inc. v. Levinson, 485 U.S. 224, 246-247.

[1426] The Supreme Court notes that "it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?" (with reference to *Schlanger v. Four-Phase Systems Inc.*,555 F.Supp. 535, 538 (SDNY 1982)); Basic, Inc. v. Levinson, 485 U.S. 224, at 246-247.

[1427] The court confirmed that reliance is an element of Rule 10b-5 cause of actions as it provides the requisite causal connection between the defendant's wrong and the plaintiff's injury. Basic, Inc. v. Levinson, 485 U.S. 224, at 243. For critical assessments of the court's adherence to the traditional common law framework, see: FISCHEL, 'Use of Modern Finance', 13: "acceptance of the fraud on the market theory, therefore leads to the conclusion that there is no need in a securities fraud case for separate inquiries into materiality, reliance, causation, and damages. These inquiries are necessary in a face-to-face transactions where each party must make a subjective valuation of information provided by the other party, but irrelevant in open market transactions where the market price transmits all relevant information." See for a similar remark: LANGEVOORT, 'Basic at twenty', 7 ff.: "Basic cannot be understood except by appreciating that the Court's response is more about evidence and civil procedure than financial economics". See also: FISCH, 'Trouble with Basic', 910-911.

traditional two-pronged notion of causation does not fit in with the fundamentally different approach to causation in FOM-claims. More particularly, since the claimant is no longer required to establish that the defendant's misstatement caused him to engage in the transaction, transaction reliance is no longer relevant and even inconsistent with the fundamentally different approach to causation in open market transactions.[1428] The adherence to the traditional framework requires the courts to bend existing concepts to fit in with the fundamentally different approach to causation and damages laid out by the market model. This is often referred to as one of the reasons for the confusing and inconsistent theoretical framework of causation and damages in US securities class action claims.[1429]

b. The notion 'efficient markets'

405. The concept of 'efficient market'. – In line with the critical assumptions of the ECMH, the application of FOM is premised on the question whether the aggrieved investor was trading on an efficient market. To qualify as an efficient market, it is required that the prices of the securities traded on the market reflect all available information. The speed and degree to which new information is absorbed in the market by professional traders determines the degree of efficiency of the market, and as such, the extent to which the stock price can be considered a correct valuation of the securities traded on the market.[1430] Despite the central position of efficiency in the ECMH, the development and formulation of precise criteria and conditions to assess whether or not a market is efficient, have proven difficult and somewhat elusive causing confusion and uncertainty in the US courts.[1431] Factors determining whether or not a market is efficient have nonetheless been studied extensively. GILSON and KRAAKMAN for instance stressed the importance of institutional factors – including legal

[1428] FOX, 'After Dura', 839 ff.; M.B. FOX, 'Demystifying Causation in Fraud-on-the-Market Actions', 60 *Bus. Law.*, 2005, 516.

[1429] Idem.

[1430] A distinction is made on basis of the degree of efficiency in the ECMH. Traditionally, three gradations of efficiency are distinguished: the strong, semi-strong and weak form of efficiency. The weak form implies that security prices reflect all the available information reflected by the past prices of the security at matter. The semi-strong form means that prices reflect all publicly available information, including new information when made public. The strong form is used to indicate that the prices reflect all information, regardless of its public availability. Research has confirmed the existence of the weak and semi-strong form of market efficiency, though no evidence was established with regard to the strong form; consult on this topic (amongst others): E. FAMA, 'Efficient capital markets II', 46 *JFE*, 1991, 1575-1617; R.A. HAUGEN, *Modern Investment Theory*, Prentice Hall, Englewood cliffs, NJ, 1997, chapter 24. See also: COX, HILLMAN and LANGEVOORT (eds.), *Securities Regulation*, 106; P. BARNES, *Stock market efficiency, insider dealing and market abuse*, Farnham, Gower, 2009, 45; FISCHEL, 'Efficient capital markets', 911; GILSON and KRAAKMAN, 'The mechanisms of market efficiency', 549; P.J. ENGELEN, 'Hoe communiceren beursgenoteerde vennootschappen met de financiële markten? Naar een nieuwe beleidsdoelstelling voor beursregulering', *V&F* 2000, 101; P.J. ENGELEN, *Informatieverstrekking door beursgenoteerde vennootschappen*, Antwerpen, Intersentia, 1999, nr. 12 en 13. For an overview with regard to the efficiency of the Brussels stock exchange for instance: R. GILLET, 'Efficience informationnelle de Bourse de Bruxelles: une synthèse', *Revue de la Banque*, 1992, n° 2, 75-83 and references cited. Research has confirmed the existence of the weak and semi-strong form of market efficiency, though no evidence was established with regard to the strong form; consult on this topic (amongst others): FAMA, 'Efficient capital markets II', 1575-1617; HAUGEN, *Modern Investment Theory*, chapter 24. See also: COX, HILLMAN and LANGEVOORT (eds.), *Securities Regulation*, 107.

[1431] Summarized, the Polymedica court put it as follows: "The fraud-on-the-market presumption of reliance and its relationship to market efficiency can thus be reduced to the following syllogism: (a) an investor buys or sells stock in reliance on the integrity of the market price; (b) publicly available information, including material misrepresentations, is reflected in the market price; and therefore, (c) the investor buys or sells stock in reliance on material misrepresentations. This syllogism breaks down, of course, when a market lacks efficiency, and the market does not necessarily reflect the alleged material misrepresentation." In re PolyMedica Corp. Securities Litigation, 432 F.3d 1 (1st Cir. 2005). See on the assessment of market efficiency by the US courts: G. ERENBURG, J.K. SMITH and R.L. SMITH, 'The paradox of "Fraud-on-the-Market Theory": Who relies on the Efficiency of Market Prices', 8 *J. Empirical Legal Stud.*, 2011, iss. 2, 260.

institutions – for market efficiency.[1432] Furthermore, the presence of sophisticated professionals who trade on an informed basis is invariably considered indispensable to market efficiency.[1433]

US Courts have also developed criteria to determine whether or not a market can be considered efficient. A notable example of the latter is the five-factor test developed in *Cammer v. Bloom*.[1434] Using factors as (1) the stock's average trading volume, (2) the number of analysts tracking the company, (3) presence of market makers and arbitrageurs, (4) eligibility for an S-3 registration that entitles the issuer to offer securities via a simplified securities registration form[1435] and (5) a historical showing of immediate price response to unexpected events or financial releases, the court in *Cammer* decided whether or not a market could be considered efficient.[1436] Whilst the multifactor *Cammer*-test was endorsed in various other decisions, some courts chose to add criteria whereas others rejected the test.[1437] Hence, no conclusive test or bright line rules with regard to the determination of market efficiency have been developed so far.[1438]

c. *Rebuttal of the FOM-presumption*

406. Finally, it should be noted the defendant can rebut the presumption by establishing evidence of either the immateriality of the information at matter, or the fact that the plaintiff did not rely on the information.[1439]Another manner to rebut the presumption is establishing evidence that the market at

[1432] GILSON and KRAAKMAN, 'The mechanisms of market efficiency', 597. The authors mention the presence of mandatory disclosure rules for instance, as such rules may be important for market efficiency because they reduce the costs of searching and gathering the information relevant to traders looking for it, improving the speed and availability of information, thereby enhancing efficiency. Other factors found to play a major role are insider trading prohibitions for they provide a safeguard for those trading on information that the advantage of their efforts in processing and analyzing the information can be fully gained. Furthermore, a ban on misleading information increases the reliability of disclosures. See in this regard: GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 732.

[1433] GOSHEN and PARCHOMOVSKY, 'The essential role of securities regulation', 730 ("The more skilled information traders or insiders can counter price-value discrepancies caused by noise traders or by newly disclosed information, the more efficient the market is").

[1434] Cammer v. Bloom, 711 F. 9 F. Supp. 1264 (D.N.J. 1989). On the Cammer factors and their impact on US court decisions, see also: D. TABAK, 'Do Courts Count Cammer Factors?', 2012, www.nera.com 1-5. The latter publication – carried out by NERA, an economic consulting firm that represents often the defendant's side in securities fraud class actions – shows that an analysis of court decisions based on the five *Cammer*-factors yields highly similar results as an analysis based on only three *Cammer*-factors with regard to the efficiency of a market.

[1435] On S-3 registration, see for instance: COX, HILLMAN and LANGEVOORT (eds.), *Securities Regulation*, 164-166.

[1436] In re Nature's Sunshine prods. Inc. Sec Litig., 486 F.Supp.2d 1301, (D. Utah, 2007). See on this topic also: W.O. FISHER, Does the Efficient Capital Markets Hypothesis Do Us Justice in a Time of Madness?, 54 *Emory L. J.*, 2005, 859; COX, HILLMAN and LANGEVOORT (eds.), *Securities Regulation*, 711; TABAK, 'Cammer Factors', 1-5; B. CORNELL and J. RUTTEN, 'Market efficiency, crashes and securities litigation', 81 *Tul. L. Rev.*, 2006, (443) 453.

[1437] In Unger v. Amedisys Inc., 401 F.3d 316 (5th Cir. 2005); Binder v. Gillespie, 184 F.3d 1059 (9th Cir. 1999); Krogman v Sterritt 202 F.R.D. 467 (2001); In re DVI Inc. Securities Litigation,249 F.R.D. 196 (2008); see also: In re PolyMedica Corp. Securities Litigation, 432 F.3d 1 (1st Cir. 2005). The latter is generally described as an outlier since the court in *PolyMedica* held that a market is efficient for FOM purposes when the stock price "fully reflects all publicly available information" (at 19) and thereby rejected the district court's holding that the stock price need only reflect "most" publicly available information. With regard to "fully reflect," the court clarifies "that market price responds so quickly to new information that ordinary investors cannot make trading profits on the basis of such information. This is known as "informational efficiency." We reject a second and much broader meaning of "fully reflect," known as "fundamental value efficiency," which requires that a market respond to information not only quickly but accurately, such that the market price of a stock reflects its fundamental value" (PolyMedica Corp. Securities Litigation, 432 F.3d 1 (1st Cir. 2005)).See in this regard also: FISHER, 'Does the Efficient Capital Markets Hypothesis Do Us Justice', 859, ftn. 42. For a discussion on these criteria and Krogman v Sterritt 202 F.R.D. 467 (2001) in particular, see also: CORNELL and RUTTEN, 'Market efficiency', 453 ff.

[1438] TABAK, 'Cammer Factors', 1; FISHER, 'Does the Efficient Capital Markets Hypothesis Do Us Justice', 863.

[1439] "Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff or his decision to trade at a fair market price will be sufficient to rebut the presumption of reliance". Basic, Inc. v. Levinson, 485 U.S. 224 (1988); Affiliated Ute Citizens of Utah v United States, 406 U.S. 128 (1972).

matter is not efficient, as illustrated by the Second Circuit decision in *In re Initial Pub. Offering Sec. Litig.*[1440]As noted in the literature however, if the deficient information is material and the market is considered efficient, defendants are unlikely to succeed in rebutting the presumption as the lack of reliance is hard to prove.[1441]

4. Assessment of FOM in the light of the reevaluated insights on market efficiency

407. As mentioned in the preceding section, FOM was derived from the then innovative insights on the interaction between information and securities pricing in the US finance literature. Even though unassailable at that point in time, the ECMH has become contested over the recent decades, mostly as a result of research carried out by behavioral finance scholars. The implications of the FOM-doctrine, based on the financial economic premises of ECMH, are discussed from the perspective of these evolving insights.

a. The criticism and doubts casted on the ECMH[1442]

408. Whereas the ECMH was widely accepted in financial economics as one of the most important evolutions in finance literature, the theory has been severely contested over the last two decades, most notably by the behavioral finance literature.[1443] The core of the criticism concerns the ‘rational investor’ assumption underlying the ECMH. More particularly, whereas the basic assumption of the ECMH poses that investors react rationally to new information – which is reflected in the securities prices following the transactions effectuated by these rational investors – behaviorists claim that investor rationality is bounded. Phenomena such as herding and noise trading, bubbles and crashes illustrate the criticism of the behavioral finance literature on the rationality-assumption in the context of stock markets. Other studies showed that when confronted with an overload of information, investors tend to make less accurate decisions compared to when they had no information and could only rely on intuitive elements.[1444] The limited cognitive abilities together with sentiments with an impact on investment behavior, such as fear or optimism or even euphoria, result in anomalies distorting the efficient price formation process and explain the development of bubbles and crashes, as well as herding behavior.[1445] As a result of these sentiments and phenomena, it was found that market prices do not consistently and invariably reflect the intrinsic value of the securities, rendering

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[1440] In re Initial Pub. Offering Sec. Litig., 471 F.3d 24, 42-43 (2d Cir. 2006).

[1441] ERDLEN, 'Timing is everything', 896.

[1442] This thesis does not aim to present a comprehensive overview of the (behavioral) finance literature in this regard, yet only mentions criticism and problems relating to the ECMH insofar relevant for the subject of this thesis.

[1443] Behavioral science refers to finance from a broader social science perspective and includes psychology and sociology. See on this topic for instance: R.J. SHILLER, 'From efficient markets theory to behavioral finance', 17 *JEP*, 2003, nr. 1, 83-104; R.J. SHILLER, *Irrational exuberance*, Princeton, Princeton University Press, 2000, 296 p.; F. DUNBAR and D. HELLER, 'Fraud on the market meets behavioral finance', 31 *Del. Journ. Corp. L.*, 2006, 455-532; L. RIBSTEIN, ‘Fraud on a noisy market’, 10 *Lewis & Clark L. Rev.*, 2006, 139-141; P.A. FERILLO, F.C. DUNBAR and D. TABAK, 'The less than efficient capital markets hypothesis: requiring more proof from plaintiffs in Fraud-on-the-Market cases', 78 *St. John’s Law Journal*, 2004, 81-129; T. DEBELS, *Behavioral finance: motivatiepsychologie van de belegger*, Antwerpen, Garant, 2006, (280p.); A. SCHLEIFER, *Inefficient markets: an introduction to behavioral finance*, Oxford, Oxford University Press, 2000, 1 ff.; H. SHEFRIN (ed.), *Beyond greed and fear: understanding behavioral finance and the psychology of investing*, Boston, Harvard Business School Press, 2000, 33 ff.; R.J. GILSON and R. KRAAKMAN, ‘The mechanisms of market efficiency twenty years later: the hindsight bias’, 28 *J. Corp. L.*, 2002-2003, 722 ff.; E. FAMA, 'Market efficiency, long-term returns, and behavioral finance', 49 *JFE*, 1983, 283 (reconciling ECMH with more recent financial studies). Also: ALLEN, 'Securities markets', 552 ff.; STOUT, 'Mechanisms of Market inefficiency', 660 ff. and the references cited (ftn. 115 and 116).

[1444] PAREDES, 'Blinded by the light', 419, 442 ff.

[1445] See also the references cited in the previous footnotes.

fundamental efficiency of securities prices illusionary in these cases. These criticisms have been voiced for years and became even louder as the financial crisis of 2007 unfolded.[1446]

409. Besides the rationality assumption, other ECMH assumptions have been put to doubt too. For example, a strict interpretation of the ECMH suggests that any effort made by investors to study publicly available information on particular issuers in order to exploit mispricing is fruitless from the outset because the markets – if efficient – incorporate newly published information more or less immediately. As a result, from this point of view it is sheer impossible for investors to beat the market in a consistent manner.[1447] Yet this assumption has run counter to evidence from the markets, as some investors did consistently beat the market, indicating that these investors did succeed in identifying mispriced securities with some consistency.[1448] Moreover, as GROSSMAN and STIGLITZ pointed out, unless some investors disregard the implications of ECMH and invest in resourcing information and locating mispricing, prices would be inefficient.[1449] Finally, according to the leading literature, perfect efficiency can only exist to the extent information is immediately available without any costs.[1450] Evidently, or so it now seems at least, in reality information is not always immediately available nor is it costless.[1451]

410. Refinements and corrections of the ECMH. – These findings and insights have put basic assertions and expectations related to the ECMH to doubt and caused scholars to deepen the theory with refinements and corrections. One of these refinements for instance concerns the difference between informational efficiency on the one hand, and fundamental efficiency on the other.[1452] Whereas the notion of fundamental efficiency implies that stock prices traded on efficient markets accurately reflect the intrinsic value of a security, informational efficiency concerns the time needed for new information to be incorporated in the price.[1453] Behavioral theories and evidence regarding noise trading and financial crashes have demonstrated that contrary to what the classical ECMH projects, securities prices may fail to serve as a reliable indicator of the securities' underlying, intrinsic value. As a result,

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[1446] G. AKERLOF and R.J. SCHILLER, *Animal spirits*, Princeton, Princeton University Press, 2009, p. explaining how the crisis of 2008 involved changing thought patterns that animate peoples' feelings about something, including investments. Emotions such as (over)confidence, envy, resentment, fairness etc. play a role in (major) economic events, such as the crisis, according to the authors and only in understanding these thought patterns, more insight in the emergence of certain economic events may be achieved.

[1447] S.J. GROSSMAN and J.E. STIGLITZ, 'On the impossibility of informationally efficient markets', 70 *Am. Econ. Rev.*, 1980, iss. 3, 393. This argument is also known as an often-repeated investment joke that comes in many different versions. A common version is the one with two economists walking down the street when both see a $100 dollar bill on the ground. One asks the other, "should I pick it up?" The other says, "Don't bother, the markets are efficient and therefore someone else already has."

[1448] L. STOUT, 'How efficient market undervalue stocks: CAPM and ECMH under conditions of uncertainty and disagreement', 19 *Cardozo L. Rev.*, 1997, 476 and references cited (ftn. 12 in particular).

[1449] GROSSMAN and STIGLITZ, 'On the impossibility', 393.

[1450] See for instance: FAMA, 'Efficient capital markets', 387; J.R. MACEY, G.P. MILLER, M.L MITCHELL and J.M. NETTER, 'Lessons from financial economics, materiality, reliance and extending the reach of Basic v. Levinson', 77 *Va. L. Rev.*, 1991, 1022.

[1451] See extensively on these assumptions: GILSON and KRAAKMAN, 'The mechanisms of market efficiency', 552; GROSSMAN and STIGLITZ, 'On the impossibility', 393-408.

[1452] STOUT, 'Mechanisms of Market inefficiency', 640; B. LEV and M. DE VILLIERS, 'Stock Price Crashes and the 10b-5 Damages: A Legal, Economic, and Policy Analysis', 47 *Stan. L. Rev.*, 1994-1995, 20.

[1453] For fundamental efficiency requires perfect efficiency in terms of immediate availability of and costless access to new information, it is not considered a common feature of capital market anymore. Or put differently, "[f]undamental value efficiency is a theoretical rabbit pulled out of a hypothetical hat. If investors disagree in their forecasts, there is no a priori reason to assume that securities prices will mirror the best possible estimates of their expected risks and returns. Nor is there good reason to be surprised by the increasing empirical evidence that, in fact, they do not" (STOUT, 'Mechanisms of Market inefficiency', 650). *Comp*.: J.B.S. HIJINK, *'Publicatieverplichtingen voor vennootschappen'*, Deventer, Kluwer, 2010, 301.

markets are not believed to be fundamentally efficient, yet this does not automatically imply that information does not impact the pricing mechanism on the market. More particularly, even though securities prices may fail to reflect the economic value of a security, they may still be informational efficient in the sense that securities prices react quickly to new information.

b. Uncoupling ECMH from the market model

411. The discussion on the ECMH is however only relevant to this thesis to explain and illustrate the interaction between securities prices and information, as this interaction is critical to the market model and explains why investors can be deceived by misleading information by simply relying on the integrity of market prices. More particularly, precisely because it provided the US Supreme Court with an objective and prominent financial economic theory illustrating the interaction between market pricing and information, the ECMH has proven instrumental to realize the shift from the traditional transaction model with a focus on investors relying on issuer disclosures in making investment decisions towards the market model, which instead focuses on investors relying on the integrity of market prices. Yet the validity of the market model should not be confused with the validity of the ECMH.[1454] More particularly, to determine whether investors have been deceived by misstatements to the market is not premised on the question whether markets are efficient, but instead on the question whether the misstatements distorted the price of the affected security (informational efficiency). Put differently, to apply the market model, it is relevant to determine whether the price of particular securities has been impacted by the occurrence of (wrongful) disclosures or omissions of material information. Whether the price reaction to the information accurately reflects its intrinsic value on the other hand, is not relevant (fundamental efficiency).

D. Interim conclusion: the US originated market model assessed

412. The adoption of FOM proved highly important to US investor litigation. Not only did the US Supreme Court acknowledge the difficulties investors encountered in establishing reliance, it also recognized the specific information mechanism that characterizes open, liquid securities market. By referring the ECMH as the financial economic foundation for the legal doctrine, the court acknowledges that investors do not directly rely on all information made available to the investor public, but may instead rely on the integrity of the market prices. Although the court's willingness to approach causation from a new and different perspective is indisputably innovative, it was observed that the court refused to abandon the traditional common law background and bend the concept of reliance rather than abandoning it in order to reconcile it with the newly adopted approach to causation.[1455]

[1454] MACEY, MILLER, MITCHELL and NETTER, 'Lessons from financial economics', 1017 (p.1018: "We suggest that the focus of the Supreme Court's holding in Basic is misplaced: what determines whether investors were justified in relying on the integrity of the market price is not the efficiency of the relevant market but rather whether a misstatement distorted the price of the affected security"); SPITZ, *La réparation*, 354, para. 569; FISCH, 'Trouble with Basic', 898 ("Although market efficiency is neither a necessary or sufficient condition to establish that misinformation has distorted prices, most courts have concluded that the threshold inquiry in Basic is satisfied by proof that the misrepresentations were publicly made and 'that the stock trades in an efficient market'").

[1455] FISCHEL, 'Use of Modern Finance', 13: "acceptance of the fraud on the market theory, therefore leads to the conclusion that there is no need in a securities fraud case for separate inquiries into materiality, reliance, causation, and damages. These inquiries are necessary in a face-to-face transactions where each party must make a subjective valuation of information provided by the other party, but irrelevant in open market transactions where the market price transmits all relevant information." See for a similar remark :LANGEVOORT, 'Basic at twenty', 158: "Basic cannot be understood except by appreciating that the Court's response is more about evidence and civil procedure than financial economics".

413. The adoption of FOM accounts for one of the most radical changes of the US investor litigation landscape and has stirred the debate more or less incessantly since its introduction. A first line of criticism opposed FOM arguing that the combination of class actions with the FOM-doctrine has facilitated investor claims beyond reasonable bounds and has led to the emergence of the so-called 'strike' suits.[1456] The latter refers to rent-seeking claims or frivolous claims aimed at coercing the defendant into a settlement by the threat of expensive discovery costs in case of proceeding the claim in court regardless of the merits of the case.[1457] The fact that investors have agreed to settle for relatively small compensations is argued to support this assertion. The fact that foreign investors (meaning non-US investors) were found to actively engage in forum shopping to file claim in US courts specifically because of its claimant-friendly reputation added further fuel to the criticism.[1458] As a result, securities class actions have been the subject of controversy for several decades now, centered on the argument that class actions based on FOM induce vexatious and abusive claims.

414. Although much discussed and written about, no convincing evidence of actual strike suits flooding US courts, has been presented, causing some to conclude that the discussion has a higher rhetorical than empirical strength.[1459] Secondly, the fact that harmed investors content themselves with relatively small compensations does not indisputably indicate that investors have no meritorious claims, but should be considered in the broader US litigation system and the costs associated with

[1456] 'Strike suits' are suits that are meritless, yet still end up being settled because settlement is cheaper and faster for the defendant than proceeding the claim and paying discovery and other litigation costs. COFFEE, 'Reforming Securities Class Action', 1536, ftn. 5; J.D. FULOP, 'Agency Costs and the Strike Suit: Reducing Frivolous Litigation through Empowerment of Shareholders', 7 *J. Bus. & Sec. L.*, 2007, 213.

[1457] After the class action is filed, courts are required to consider whether the requirements for class certification are met in the light of Rule 23(b) (3) US Federal Rules of Civil Procedure. The latter requires that "questions over law and fact common to the member of the class predominate over any questions affecting individual members" (more extensively on the requirement of Rule 23(b) (3): P.G. KARLSGODT, 'The United States', in P.G. KARLSGODT (ed.), *World Class Actions*, Oxford, New York, Oxford University Press, 2012, 22 ff.). Only after certification is granted, the case is assessed on its merits. Most of the securities class actions passing the class certification phase however are settled because parties prefer to avoid further expensive proceedings. It was found that one third of all filed federal securities class action fails to get certified. Of the two thirds that are certified, the majority of the cases gets settled and very few make it to trial. As a result, getting certification is a watershed moment in the securities class action procedure, which is illustrated by the cases and battles fought over the requirements to get certified and those to be met only when the case is assessed on its merits. The importance of certification is also illustrated by two relatively recent US Supreme court battles, being Erica P. John Fund, Inc. v. Halliburton Co., 131 S.Ct. 2179 (2011) and recently decided: Amgen, Inc, v. Connecticut Retirement Plans and Trust Funds, no. 11-1085, decided February 27, 2013. The first case dealt with the question whether loss causation must be proven in order to get certification, whereas the latter concerns the question whether materiality needs to be proven for certification. See on this topic also (amongst many others): T.J. MULLANEY, 'Theories of measuring damages in security cases and the effects of damages on liability', 46 *Fordham L. Rev.*, 1977, 277-278; BURCH, 'Reassessing damages', 348 ff. and references cited; M. KLAUSNER and J. HEGLAND, 'When are securities class actions dismissed, when do they settle, and for how much? Part II', vol. XXIII *Plus*, 2010, No. 3 1; FISCH, 'Trouble with Basic', 926.

[1458] The attractiveness of US courts to foreign investor-litigants was a much discussed topic following claims filed against Vivendi for securities fraud by both US and non-US (French) investors. Instead of filing their claim in France, the latter preferred to join the US class action although they had little to no ties to the US court system, other than that the multinational Vivendi was also listed in the US and sued by US investors for similar facts. See on the topic: V. MAGNIER, 'L'affaire Vivendi entre rêve américain et cauchemar', *Rev. sociétés*, 2010, 367; M. VENTORUZZO, 'Like Moths to a Flame? International Securities Litigation after Morrison', 52 *Va. J. Int'l L.*, 2012, nr. 2, 411; AMF report on the compensation of investor and depositor losses: 'Consultation publique sur le rapport du groupe de travail sur l'indemnisation des préjudices subis par les épargnants et les investisseurs', May 2011, available at: http://www.amf-france.org/documents/general/9967_1.pdf, p. 9. The Italian Parmalat case is another example, see: FERRARINI and GIUDICI, 'Financial Scandals', 159; see also: M. JACOBY, 'For the Tort Bar, A New Client Base: European Investors', 2005, September 2, *The Wall Street Journal*. With its decision in Morrison, however, the Supreme Court put a halt to the extraterritorial reach of Rule 10b-5 in the context of investor litigation. See *infra*, para. 1708.

[1459] M.J. KAUFMAN and J.M. WUNDERLICH, 'Regressing: the troubling dispositive role of event studies in securities fraud litigation', 15 *Stan. J.L. Bus. & Fin.*, 2009, 242; see also: COFFEE, 'Reforming Securities Class Action', 1536, ftn. 5 ("The true "strike suit" nuisance action, filed only because it was too expensive to defend, is, in this author's judgment, a beast like the unicorn, more discussed than directly observed.").

proceeding the claim for both parties. More particularly, should the parties proceed to extensive (and expensive) discovery procedures, costs involved with litigation will rise steeply, inducing both parties to avoid extra costs and hassle and simply settle the claim.[1460] Furthermore, other factors such as the contingency fee, contribute to relatively low amounts of compensation.[1461] Not the FOM-doctrine in itself thus is considered to be at the root of the problem, but rather the costs associated with (securities) class actions.

415. A second line of criticism has formed around the doubts raised about the economic premises on which the court relied to adopt FOM.[1462] In its decision in *Basic* the Supreme Court essentially aimed to acknowledge the need for a fundamentally different, alternative approach to causation in open market transactions, however, rather than reflecting on financial economic theory.[1463] It was also explained in the preceding section that the ECMH caused the US courts to reflect on the relevance of information for securities prices and pricing mechanism, yet the insight that information affects securities prices does not depend on the validity of the ECMH. Instead, the alternative model draws from the observation that prices may react to new information, and deceive the investor public through manipulated prices, regardless of whether they relied on the information itself. As the US courts pioneered with this alternative approach to causation and damages in the context of securities fraud litigation, other jurisdictions have considered following its example.

III. The implementation of the market-based approach in the EU Member States

416. Presumptions of causation in investor claims have repeatedly been employed to facilitate investor claims in EU Member States, yet their reach has remained limited to the area of prospectus liability as demonstrated in the previous chapter. The concepts of causation and loss with regard to liability for ongoing disclosure obligations on the other hand have generally been governed by general liability rules. With the notable exception of Germany, where the BGH confirmed the application of the market model for liability following ad hoc disclosures, reported case law in other Member States shows that the transaction model still prevails.[1464]

[1460] COFFEE, 'Reforming Securities Class Action', 1536, ftn. 5. The author explains that the measure of damages generally awarded in securities class actions is too small for a plaintiff to invest much in the complaint, whereas the costs for the defense equally impels to settle without further (costly) hassle.

[1461] On the dynamics of FOM-settlements in the US, see *infra*, para. 509.

[1462] DUNBAR and HELLER, 'Fraud on the market', 455; L.B. LOCKWOOD, 'The Fraud-on-the-market theory: a contrarian view', *Emory L. J.*, 1989, 1302. See in this regard also: In re PolyMedica Corp. Securities Litigation, 432 F.3d 1 (1st Cir. 2005). For an overview on this strand of literature, see also: FISCH, 'Trouble with Basic', 912.

[1463] LANGEVOORT, 'Basic at twenty', 7 ff.: "Basic cannot be understood except by appreciating that the Court's response is more about evidence and civil procedure than financial economics".

[1464] Proponents of the market model (whether or not inspired on the US FOM-doctrine) are still predominantly found in academic literature rather than amongst legislators and courts in the EU Member States: France: SPITZ, *La réparation*, 163 ff.; N. SPITZ, 'La réparation des préjudices boursiers par désinformation devant la Cour de cassation: commentaire de l'arrêt de la chambre commerciale du 9 mars 2010', *RTD Fin.*, 2010, n° 260-70; MARTIN, 'La réparation du préjudice des investisseurs', 1777. UK: FERRAN, 'US-style investor suits', 7-8; Germany: amongst many others: BAUMS, 'Haftung Falschinformation', 139-192; BARTH, *Schadensberechnung*, 158; HELLGARDT, *Kapitalmarktdeliktsrecht*, 541 ff.; MÖLLERS, 'Das Verhältnis der Haftung', 1637. Belgium: VANDENDRIESSCHE, 'Fraud-on-the-market', 277; M. KRUITHOF and E. WYMEERSCH, 'Regulation and liability of credit rating agencies under Belgian law', E. DIRIX and Y.-H. LELEU, *The Belgian reports at the Congress of Utrecht of the International Academy of Comparative Law*, Brussel, Bruylant, 2006, 404; DE SCHRIJVER, 'Prospectusaansprakelijkheid', 352, 354; K. VANDERHEYDEN, *OPENBARE AANBIEDINGEN*, 282 ff.; P.D. CAMESASCA, 'Prospectusaansprakelijkheid', *DAOR* 2004, afl. 39, 21 ff.; S. DELAEY, "Barrack Mines: Prospectusaansprakelijkheid van de kredietinstelling" (comment on Kh. Brussel 17 October 2003), *DAOR* 2004, 96; T. TILQUIN, 'Occasionele informatie die de beurskoers kan beïnvloeden', *TRV* 1992, 202; DIEUX, 'Examen de jurisprudence', 260-261. The Netherlands: MENDEL, 'De Fraud on the Market-theorie', 245-256; DE JONG, *Schade door misleiding*, (2010); DE JONG, 'Liability for Misrepresentation',

A. The adoption of the market-based approach by the German Supreme Court

1. Rejection of the US fraud on the market-doctrine by the German Supreme Court

417. In response to two appellate decisions brought before the German Supreme Court, the latter considered the implications of assessing causation from the angle of an investor's general reliance on the integrity of the securities price instead of reliance on the information itself, analogous to the concept of causation as applied in the US FOM-doctrine.[1465] Finding that the notion of causation based on an investor's reliance on the integrity of the market prices would result in the endless expansion ("*uferlosen Ausweitung"*) of liability based on §826 BGB, the German Supreme Court however rejects this alternative approach to causation and loss.[1466] Interestingly, the German Supreme Court does not assess the compatibility or validity of the FOM-doctrine in a German context on its merits and conceptual implications, yet only mentions the fear for a too far-reaching liability regime for ad hoc disclosures to dismiss the suggestion.[1467]

418. Notwithstanding the German Supreme Court's reluctance to apply an alternative causation concept, the court nonetheless confirmed the possibility to claim mispricing damages ('*Kursdifferenzschaden'*) instead of the traditional rescissory measure for damages for claims based on §826 BGB ('*Naturalrestitution'*). As explained in the previous chapter, mispricing damages are damages that cover for the difference between the actual price paid and the hypothetical price that

352; A.C.W. PIJLS, 'Misleidende berichtgeving op de beurs', *TvOB* 2009, nr. 5, 131-142; A. FRANKEN, 'Op naar een civielrechtelijke aanpak van gebruik van voorwetenschap in Nederland', *Ondernemingsrecht*, 1999, nr. 15, 410-414. *Contra*: WEBER, 'Anlägeschaden', 141.

1465 BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560; also available at: http://www.bundesgerichtshof.de, and specifically para. 16; BGH 26 June 2006, II ZR 153/05, (ComROAD III), *ZIP* 2007, 326. The appellate decisions were issued by the München court of appeals, though by two different divisions. In one of the decisions, the München Court of Appeal had accepted causation consequent to the finding that the whole of the investor public, which included the individual investor-claimant, had been deceived by the highly inflated stock price. OLG München, 20 April 2005, (ComROAD IV), *BB* 2005, heft 31, 1651-1652; *ZIP* 2005, heft 20, 901. See on this decision also: MÖLLERS, 'Das Verhältnis der Haftung', 1637; RICHTER, *Schadenszurechnung*, 92-93; LEUSCHNER, 'Kausalitätserfordernis unrichtigen Ad-hoc-Mitteilungen', 1050. In the second decision, the appellate court held that the investor claimant had been deceived by the prolonged disclosures of fictitious revenues and earnings and continued stock price manipulation, in absence of which the stock price and the investment decision of the investor-claimant would have developed differently. OLG München, 28 April 2005, (ComROAD III, *ZIP* 2005, 1141, 1142. Although both decisions adhere to the reliance model in noting that the manipulation caused the investor to purchase the shares, the references to the impact of the misrepresentations on the stock prices are highly relevant to the courts' assessment of causation.

1466 BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560; also available at: http://www.bundesgerichtshof.de, and specifically para. 16: "Derartige Ansichten liefen darauf hinaus, im Rahmen des § 826 BGB auf den Nachweis des konkreten Kausalzusammenhangs zwischen der Täuschung und der Willensentscheidung des Anlegers zu verzichten und stattdessen - in Anlehnung an die sog. Fraud-on-the-market-theory des US-amerikanischen Kapitalmarktrechts - an das enttäuschte allgemeine Anlegervertrauen in die Integrität der Marktpreisbildung anzuknüpfen. Diesem Denkansatz, der zu einer uferlosen Ausweitung des ohnehin offenen Haftungstatbestandes der sittenwidrigen vorsätzlichen Schädigung auf diesem Gebiet führen würde, ist der Senat in seiner bisherigen kapitalmarktrechtlichen Rechtsprechung zu den fehlerhaften Ad hoc-Mitteilungen in Bezug auf die haftungsbegründende Kausalität nicht gefolgt." For an English (non-official) translation of the decision: CAHN and DONALD, *Comparative Company Law*, 535 ff. See on the topic (in English) also: *the Law of Tort',* 98.

1467 Note that the München courts did not apply a causation concept based on market pricing mechanisms, though only referred to the (significant) impact of the misrepresentations on the stock prices to adopt justify its lenient approach to causation. Since the court refers to the prolonged deception of the investor public as a whole in one decision, and holds that the investor-claimant followed the general line since the rest of the investor public was equally deceived, the approach used resembles the doctrine of *Anlagestimmung* rather than the US FOM-doctrine. The BGH's reference to the US FOM-doctrine in the context of *Anlagestimmung* is not that surprising however, since German literature has associated *Anlagestimmung* with the pricing mechanisms of stock markets in the sense that both US and German courts have promulgated presumptions of causation grounded on respectively the FOM-doctrine and *Anlagestimmung*. See for instance: BAUMS, 'Haftung Falschinformation', 182 ff.; noting the difference between the two theories: CASPER, 'Significance of the Law of Tort', 97, ftn. 18 and references cited; BARTH, *Schadensberechnung*, 169.

would have been paid absent the wrong.[1468] The option to choose mispricing damages as the applicable measure of damages rather than rescissory damages implies an acknowledgment of loss suffered as a result of price manipulation rather than loss suffered because of a distortion in the investment decision. Yet, even though the German Supreme Court held that compensation for losses as a result of securities mispricing could be claimed based on §826 BGB, the court did not alter its position with regard to causation and held that investors are invariably required to prove reliance according to §826 BGB. This seems at odds with the notion of mispricing damages, yet the court reiterates that no evidential facilitations or alterations are allowed according to §826 BGB.[1469] In its most recent decision in this regard based on §§37b, c WpHG however, the German Supreme Court took a different stance vis-à-vis the requirement of causation with regard mispricing damages in the context of claims filed following deficient issuer (ad hoc) disclosure.

2. The German IKB-decision unlocking the door to an alternative causation concept confined to §§37 b, c WpHG

419. Endorsement of the market model. – In its recent IKB-decision, the German Supreme Court explicitly adopted a more relaxed stance on causation. The court particularly held that recovery for losses due to deficient ad hoc disclosures based on §37b, c WpHG may either consist of (1) rescission of the transaction, or alternatively, (2) the difference between the purchase price paid by the investor and hypothetical price the investor would have paid had the issuer made adequate disclosures (‘*Kursdifferenzschaden*’).[1470] Whereas reliance on the erroneous disclosures must be established to prove causation in case of a request for rescissory damages, it suffices that the price of the security was inflated as a consequence of the misstatement, regardless of a causal link between the misinformation and the investment decision, in case only mispricing damages are demanded.[1471] The decision partly endorses the prevailing view in the literature that mispricing damages can be claimed under §§37b, c WpHG without the requirement of reliance on the misstatements, yet also differs from the standpoint advanced in the literature as the German Supreme Court still allows for rescissory damages under §§37b, c WpHG, provided that the investor relied on the information. The criticism that investors are allowed to shift general market risks to issuers in the scenario of rescissory damages

[1468] BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV). See also *supra*, para. 364.

[1469] BGH, 4 June 2007, II ZR 147/05 (ComROAD IV), *BB* 2007, 1806; *ZIP* 2007, 1560; BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV). See also: BGH 19 July 2004, II ZR, 218/03, *NJW* 2004, 2668; BGH, 4 June 2007, II ZR 173/05 (ComROAD V), available at: http://www.bundesgerichtshof.de para. 16; see also: BGH, 15 February 2006, II ZR 246/04, (ComROAD II), *ZIP* 2007, (679) 680, para. 9; BGH, 26 June 2006, II ZR 153/05, (ComROAD III), *ZIP* 2007, 326, para. 5. See (amongst others) on these decisions and the approach laid out by the BGH: WAGNER, 'Schadensberechnung', 495; CASPER, 'Significance of the Law of Tort', 99, ftn. 25; HELLGARDT, 'Praxis- und Grundsatzprobleme', 673; MÖLLERS, 'Das Verhältnis der Haftung', 1637; MÖLLERS, 'Das Verbot der Einlagenrückgewähr', 1644.

[1470] BGH, 13 December 2011, XI ZR 51/10, (IKB), available at: http://juris.bundesgerichtshof.de; see also: *ZIP* 2012, 318 with annotation by MÜLLER-MICHAELS, ‘BGH verschärft Haftung', 537. See on this decision also: HELLGARDT, 'Praxis- und Grundsatzprobleme', 673. Besides the BGH’s opinion on damages and causation in this decision, the decision is also surprising for it considers §826 BGB no appropriate legal basis whereas §826 BGB was explicitly confirmed as a valid legal basis for claims pursuant ad hoc disclosures in the series of decisions relating to ComROAD, Infomatec and EM.TV. The BGH distinguishes those decisions however based on the blatant character of the manipulation committed in those cases. Contrary to ComROAD, Infomatec and EM.TV, IKB related to a single omission on a single fact. ComROAD for instance concerned over forty highly fraudulent disclosures which created a seriously distorted perception of the company’s overall performance. The respective chairmen of the boards of directors were sentenced to prison for their deliberately manipulative behavior. The particular immorality (“*besondere Verwerflichkeit*”) with which the fraud was committed accounts for the application of §826 BGB according to the BGH, whereas the absence of such immoral behavior stands in the way of an application of §826 BGB in the IKB case. *Comp*. OLG Düsseldorf, 7 April 2011, (IKB), *BB* 2011, 2451.

[1471] HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 115 and, para. 128.

is discarded by the German Supreme Court.[1472] The court also rejects the principle advanced in the scholarly literature to deny rescission in the context of erroneous ad hoc disclosures, which holds hat that the issuer should only bear the risks related to his wrongful behavior, while investors should bear general market risks inherent to investment activities.[1473]

420. Comparison with US FOM. – This decision seems to signal a departure from the former German Supreme Court-decisions rejecting the application of the US FOM-doctrine or an equivalent thereof.[1474] In its decision, the German Supreme Court explicitly acknowledges that an investor may be deceived by misreporting, not just by reading or becoming otherwise aware of misinformation, but by means of relying on the integrity of the market and the (distorted) price he is trading for. Contrary to the US courts, the German Supreme Court has not founded this alternative approach to causation on financial economic theory, nor has it compromised between the traditional reliance requirement and the alternative causation concept.[1475] More particularly, whereas the US courts discarded the (evidential) difficulties related to reliance in adopting the FOM-presumption and fitting it in the traditional common law framework, the German Supreme Court simply abandoned the reliance requirement. Hence pursuant to the IKB-decision, only the price inflation resulting from the omission or disclosure must henceforth be established to succeed in obtaining compensation equal to mispricing damages under §§37b, c WpHG. The establishment of price inflation is generally satisfied by presenting proof of the materiality of the information disclosed or omitted, for instance in terms of a stock price reaction to the disclosure.[1476]

421. IKB-decision confined to claims based on §§37b, c WpHG. – A final remark on the causation concept adopted by the German Supreme Court in the IKB-decision concerns the scope and reach of its application. More particularly, whereas the claim in IKB was founded on §§37b, c WpHG – which solely relates to deficient ad hoc disclosure – the question has risen whether the alternative approach to causation as expressed in the IKB-decision can be extended to other causes of action, and most notably the causes of action used to bring a claim following deficient periodic disclosures (§826 BGB and §823 II BGB in combination with §400 AktG).[1477] It has been pointed out in one of the previous chapters already that diverging liability regimes for ad hoc and periodic disclosure are unwarranted and potentially susceptible of regulatory arbitrage.[1478]

B. State of play in various other Member States

[1472] BGH, 13 December 2011, XI ZR 51/10, (IKB), available at: http://juris.bundesgerichtshof.de, para. 58; *ZIP* 2012, 318. *Ibid*., §30, para. 129.

[1473] The German Supreme Court bases its decision expressly on §346 Abs. 3 Satz 1 Nr. 3 BGB. The latter legislative provision applies to restitution (‘*Rücktritt’*) of goods in the context of consumer contracts and states that the risk on further deterioration of the good is imposed on the wrongdoer. See also: PALANDT (ed.), *Bürgerliches Gesetzbuch*, §346 BGB.

[1474] In a similar sense: KLÖHN, 'Die Haftung wegen fehlerhafter Ad-hoc-Publizität', 356.

[1475] Similar: *Ibid*., 356.

[1476] In the US as well, an investor-claimant bears the burden of proof with regard to the materiality of the omission or misleading information in the context of FOM.

[1477] Noting the depart from its traditional point of view on causation in capital market liability cases yet uncertain of its implications: HAAR, 'Civil Liability of Rating Agencies', 6; also noting various unresolved questions after the IKB-decision: HELLGARDT, 'Praxis- und Grundsatzprobleme', 673. See also: HANNICH, 'Quo vadis, Kapitalmarktinformationshaftung', 449.

[1478] See *supra*, Part I, Chapter III, para. 187, and Part III, Chapter I, para. 382.

1. Comparative overview

422. Whereas the German IKB-decision unequivocally confirmed the application of the market model with regard to ad hoc disclosures, case law in other Member States does not. Although some – rather isolated – court decisions in France and the Netherlands bear traces of the market model, no comparable endorsement has been reported yet. With regard to France for instance, French case law has acknowledged and applied the market-based approach in various French court decisions, including judgments passed by the French Supreme Court. In its decision in *SG de Fonderie* for example, the Court of Appeal rejected the defendant's argument holding that the causal connection between the wrongful disclosures and the damages claimed by the investor was lacking since it could not be proven beyond reasonable doubt that the wrongful disclosure – and not the multitude of other elements likely to impact an investment decision – had caused the investor's decision to purchase the securities. Instead, the court held that the causal connection between the wrong and the damages was certain since it had been proven that the wrongful information affected the price of the securities, causing the claimant-investor to suffer losses through purchasing securities at an inflated price.[1479] The decision clearly adopts the market-based approach and was as such confirmed in cassation.[1480] Notwithstanding this decision in *SG de Fonderie* however[1481], the French Supreme Court and the lower courts seems to have changed course over time. In line with the increasing application of the loss of a chance theory in the lower courts, the Supreme Court decided in general terms that those who retain or acquire securities following deficient issuer disclosures, solely lose the chance to invest in other instruments or drop out by selling the securities at matter.[1482] The court assumes in other words than rather than suffering losses as a result of price manipulation, investors loose the chance to make another, potentially more favorable investment decision. Whereas the German Supreme Court gradually adopted the market-based approach, the French Supreme Court seems to have evolved in the opposite direction.

423. **The Netherlands.** – The Dutch Supreme Court applied price causation in *Aeilkema Veenkoloniale Bank*, a decision dating back to 1931. In this case, the court held that misleading information disseminated by the defendant had distorted the claimant-investor's assessment of the value of the instrument and had induced him to purchase the securities at a price higher than he would

[1479] The appellate court particularly held that the claimant-investors suffered losses because the price of the securities exceeded the real value of the securities as a result of the manipulation effectuated by the defendant. "[…] qu'en espèce, la certitude d'un tel préjudice est acquise, dès lors que les victimes ont acheté des actions « SGF » à un cours supérieur à leur valeur réelle et ce par suite de la diffusion de fausses informations […] ». CA Paris, 9th Ch., 15 January 1992, (*SG de Fonderie*), JurisData: 1992-020282; *Dr. sociétés*, 1992, §189, comment by H. HOVASSE; *RTD com.*, 1992, 884, comment by P. BOUZAT.

[1480] Cass., crim., 15 March 1993, (*SG de Fonderie*), pourvoi n° 92-82.263, p. 12-13; *Bull. Crim.*, 1993, n° 112, 270 ff.; see also: CLERC, 'La réparation du préjudice', 31; D. MARTIN, 'Responsabilité et marchés financiers – Propos introductifs', *Bull. Joly Bourse*, 2007, §63, 896; MARTIN, 'La réparation du préjudice des investisseurs', 1777.

[1481] See also the appellate decision in *Gontier* in which the Paris appellate court held that the price evolution between the first of January and the 21st of July shows that a price increase occurred and corresponds with the dissemination of erroneous information and allows for the conclusion that the dissemination of the deficient information is causally related to the price increase ("le graphique d'évolution des cours entre le 1er janvier 2003 et le 21 juillet 2003, ainsi que les constatations, non contestées, de la décision à cet égard, attestent de la concomitance de la diffusion des informations trompeuses avec la hausse du cours du titre d'EEM, et partant, du lien de causalité entre ces deux événements, excluant les autres causes invoquées par le requérant"). CA Paris, 29 January 2008, no. 07/00101, available at http://www.legifrance.gouv.fr.

[1482] Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (SA EPF Partners/A.), *La Semaine Juridique Entreprise et Affaires, 2010*, n° 20, Mai, 1483, with annotation by S. SCHILLER; see on this decision also: SPITZ, 'La réparation des préjudices boursiers par désinformation', 60.

paid in absence of the fraudulent information.[1483] *Aeilkema Veenkoloniale Bank* is, however, the only decision in which the Dutch Supreme Court expressly applied price causation. Later decisions refer to the requirement of reliance on the information itself, or remain vague or even silent on the analysis of causation. For instance, it its judgment in *Philips/VEB* concerning investor claims for erroneous ad hoc information, the Supreme Court decided that "with respect to those who relied on the information, the issuer was to be held responsible".[1484]

It was not until recently in the aforementioned World-Online decision that the Dutch Supreme Court and its Advocate-General reconsidered the requirement of causation following deficient issuer disclosures.[1485] Interestingly and similar to the German case law, the US FOM-doctrine was considered on its merits and relevance in the light of the Dutch legal framework.[1486] Although it is expressly acknowledged that the traditional approach to reliance is problematic for investors claiming losses following deficient disclosure, the Advocate-General nonetheless counseled against the adoption of a FOM-like doctrine. The exact reasons for this reluctance are not elaborated, yet the conclusion does mention the criticism and doubt casts on the FOM-doctrine, mostly based on its predication on the ECMH.[1487] As already indicated however, the price-causation model is not by all means dependent on the validity of the ECMH, as courts and literature in the US and in Europe have come to acknowledge.[1488] The distortion of the price (informational efficiency) as a result of the deficient disclosure suffices to establish liability, regardless of whether or not the market was efficient. Moreover, as the World Online-decision has left the question with regard to the requirement of causation in case of erroneous secondary information unanswered, the assessment of causation with regard to ongoing disclosure obligations has become the subject of a considerable stream of literature.[1489] Other than the Advocate-General in his conclusion, the prevailing view in the scholarly literature advocates a different approach to causation by focusing on the causal connection between disclosures and the price formation process, rather than the traditional reliance requirement.[1490]

424. UK. Reliance requirement in s.90A FSMA. – Whereas reliance is a standard requirement in the common law torts of negligence and fraud, it was already clarified that in the context of prospectus liability claims filed according to s.90 FSMA, no reliance must be established, provided that the misrepresentation affects the market price of the security.[1491] Contrary to prospectus liability however,

[1483] HR 11 December 1931, (*Aeilkema Veenkoloniale Bank*), *NJ* 1932, with ann. by P. SCHOLTEN, 161. See on this decision and its implications also: DE JONG, 'Class actions made difficult', 514; DE JONG, *Schade door misleiding*, 122.

[1484] HR 7 November 1997, *NJ* 1998, 268, comment by J.M.M. MAEIJER. Philips had disclosed information too optimistic, allegedly inducing the claimants to invest in Philips securities.

[1485] Although the decision itself concerned prospectus liability claims, the conclusion also discusses causation and liability rules in the context of erroneous secondary market information from a comparative perspective.

[1486] Concl. AG Timmerman on HR 27 November 2009, available at http://rechtspraak.nl, r.o. 4.7.5.

[1487] Concl. AG Timmerman on HR 27 November 2009, available at http://rechtspraak.nl, r.o. 4.7.5.5-4.7.5.6.

[1488] MACEY, MILLER, MITCHELL and NETTER, 'Lessons from financial economics', 1018; SPITZ, *La réparation*, 354, para. 569; FISCH, 'Trouble with Basic', 912.

[1489] See in the same sense: DE JONG, 'Liability for Misrepresentation', 356; DE JONG, *Schade door misleiding*, 159-160.

[1490] PIJLS, 'Het causaliteitsvereiste bij prospectusaansprakelijkheid', 185 ff.; DE JONG, *Schade door misleiding*, 160 ff.; L. TIMMERMAN, 'De aansprakelijkheid van de syndicaatsleider voor een misleidend prospectus', J.R. SCHAAFSMA, S PERRICK and D.H. CROSS, *Ontwikkelingen in het effectenverkeersrecht*, Deventer, Kluwer, 1996, (65) 81; HOFF, 'De lessen van het Co op-Arrest', 366-367; A.G. MARIS and S.A. BOELE, 'Prospectusaansprakelijkheid', *TVVS*, 1994, afl. 94/6, 146; LEIJTEN, 'Prospectusaansprakelijkheid', 221-222; VAN DE BRAAK, 'Kannenbier tot Coop', 22; DE JONG, 'Class actions made difficult', 514 ff.

[1491] See *supra* para. 328. See also: HUDSON, *Securities Law*, 23-15 – 23-16; ALCOCK, 'Misinforming the market', 251; DAVIES, *Principles of Modern Company Law*, 25-32; HUDSON, *Charlesworth's Company Law*, 14-016. In the discussion paper drafted by DAVIES on the reform of the statutory liability regime for issuer liability following misstatements, reference the requirement of reliance was explicitly retained in the statutory regime designed to deal with issuer liability following misrepresentations in secondary market information in order to forestall the application of the market model, similar to the US FOM-doctrine.[1492] The statutory tort contained in s.90A FSMA was modeled to the tort of deceit in other words, precisely because the legislator did not aspire to facilitate investor claims following misleading secondary market information.[1493] The fear for frivolous, abusive claims after the US example seems to have prompted this explicit choice for the transaction model, even though no convincing evidence has been presented that abusive claims are indeed being filed in the US.[1494] Moreover, despite the feeling that securities litigation would operate very differently in the UK from the manner it is being operated in the US because of the very different procedural environments, the legislator nonetheless remains reluctant to adopt changes with regard to liability claims for erroneous ongoing reporting.[1495]

2. Interim conclusion: the limited impact of the market based-approach in the EU Member States

425. Overall, it seems that the development of the market model in the various Member States is taking place at different paces, based on differing insights and policy concerns. Whereas the Dutch and the Belgian courts have not expressly taken position on the matter and remain silent or hesitant, the French Supreme Court chose the doctrine of the loss of a chance as the standard approach and has mostly disregarded the market model as an alternative so far. The UK legislator on the other hand did reject the market model expressly with regard to secondary market information. In order to rule out that courts would introduce a model similar to the US FOM-doctrine, the requirement of reliance was anchored in statutory provisions governing secondary market misreporting in s.90A FSMA. The German Supreme Court on the other hand has moved in the opposite direction with a clear endorsement of the alternative price causation approach, yet only to the extent it concerns claims for ad hoc disclosures brought on basis of §§37 b, c WpHG.

426. Regardless of the course taken however, various questions with regard to the implications and implementation of the market model have remained unanswered so far. One of the most pressing matters in this regard concerns the concept of recoverable loss in the context of the market model. Whereas the German Supreme Court expressed confidence in the development of such alternative concept loss with reference to modern finance theories, the literature has taken different views on the compensation of '*Kursdifferenzschaden*'.[1496] Interestingly, this is not a typical German matter. Even in

to the FOM-doctrine is made with regard to s.90 FSMA (DAVIES, 'Davies review. Discussion paper', para. 55 and in ALCOCK, 'Misinforming the market', 249, ftn. 33 in particular).

1492 Schedule 10A, para. 3 (4). See also: DAVIES, 'Davies Review: Final Report', p.4; DAVIES, 'Davies review. Discussion paper', para. 26, 55 and 116; ALCOCK, 'Misinforming the market', 248; DAVIES, 'Liability for misstatements', 296; HUMPHERY-JENNER, 'Securities Fraud Compensation', 149.

1493 Note that FERRAN discusses whether or not FOM can be applied under s.90A FSMA from a perspective of 'inferred reliance': FERRAN, 'US-style investor suits', 326-328. It is particularly argued that when one accepts that the securities price was focal for the investment decision, it could be argued that reliance on the integrity of the price is tantamount to (inferred) reliance on the information itself (p.328).

1494 KAUFMAN and WUNDERLICH, 'The troubling dispositive role of event studies', 242; COFFEE, 'Reforming Securities Class Action', 1536, ftn. 5. See also *supra*: para. 414.

1495 Discussing potential amendments and reviewing market responses to a public review document regarding s.90A FSMA, most respondents referred to the funding mechanism of US class actions as the foremost driver of US securities litigation, and more particularly to the system of contingency fees and the op out-system underlying the US class action. DAVIES, 'Davies review. Discussion paper', para. 115 ff.

1496 BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV) at 1274 ("Der Differenzschaden in Form des Unterschiedsbetrages zwischen dem tatsächlich gezahlten Transaktionspreis und dem Preis, der sich bei pflichtgemäßem Publizitätsverhalten gebildet hätte, ist entgegen der Ansicht des Berufungsgerichts grundsätzlich ermittelbar. […]so besteht the US, where the market model has been developed and accepted in the form of the FOM-doctrine decades ago, no clear-cut definition of recoverable damages has emerged yet.

IV. The concept and calculation of recoverable loss in the light of the securities-pricing model

A. *The concept of recoverable loss*

427. Emergence of recoverable loss. – According to the market model, recoverable losses are those losses suffered as a result of price distortions resulting from wrongful disclosures, or the mispricing loss. The market model hence focuses on the loss resulting from the impact of the challenged conduct on the market price of the security instead of the loss resulting from the investment decision that was induced by the wrongful information. Although this delineation of recoverable losses may appear straightforward at first sight, its application in practice has shown to be fairly complex and problematic in (US) legal practice and literature. Besides evidentiary issues – discussed further below under a separate heading – courts and literature have struggled with the conceptualization of what constitutes a recoverable economic loss in the market-based approach. The difficulty particularly relates to the question whether recoverable loss emerges as soon as transactions are being carried out against distorted securities prices, or whether the loss only arises at the moment when the distortion dissipates, i.e. when the market realizes there has been a price deformation and responds to its realization by adjusting the price.

428. Besides the need to conceptually delineate recoverable losses in the market based approach, the question is also relevant when the initial price distortion differs from the price reaction to the corrective disclosure. Examples include cases in which the initial relevance or impact of the information has relatively changed in the light of other circumstances or market tendencies that have developed in the meantime. The possibility of a varying degree of price distortion has for instance been illustrated in the literature with an example involving an oil company misrepresenting its oil supplies. Since the value of having certain supplies depends on the current oil price, the value of the misleading information varies depending on the volatility of the oil price during the period of price inflation, which is amongst other things, influenced by the available reserves worldwide. Accordingly, oil price fluctuations may cause a varying degree of price distortion during the distortion period, for instance when oil production quotas are imposed or changed, a (massive or at least substantial) discovery of oil is announced.[1497]

429. Secondly, the question when loss emerges may also be relevant in the light of intervening factors, such as bankruptcy, before the deception is publicly noticed.[1498] Assume for instance an investor purchasing securities of a certain company against an inflated price caused by misleading or omitted information. Prior to any discovery of the misstatements however, the company goes bankrupt

doch in der herrschenden Meinung der Literatur Übereinstimmung, daß sich […]er hypothetische Transaktionspreis mit den Methoden der modernen Finanzwissenschaft durchaus mit der erforderlichen Sicherheit errechnen läßt“). With regard to the differing view in the (German) literature, see further below.

[1497] This example was initially provided by judge SNEED in his highly influential occurring opinion in Green v. Occidental Petroleum Corp. 541 F.2d 1335 (9th Cir. 1976) at 1345, ftn. 6-7; and has been cited (amongst others) in DE JONG, *Schade door misleiding*, 118; BARTH, *Schadensberechnung*, 242.

[1498] See in this regard also: D. TABAK, 'Loss Causation and Damages in Shareholder Class Actions: When It Takes Two Steps to Tango', 2004, NERA, available at: http://www.nera.com, 11 ff.

and the stocks lose all value. If recoverable loss emerges only when the distortion is noticed and the price is adjusted as a result, no recoverable loss is suffered in the latter scenario. If the inflation as such is however considered recoverable loss because one is paying too much, then recoverable loss has been suffered.[1499]

430. Notwithstanding its relatively extensive experience with the market-based approach, US courts have not yet succeeded in developing an unambiguous and consistent concept of recoverable damages and the contours of the requirement of causation to prove that the loss has actually been caused by the misrepresentation.[1500] The text below discusses the US courts' struggle with the conceptualization of recoverable losses, draws a comparison with the German concept of *Kursdifferenzschaden* as developed in the literature and recently adopted in the courts, and suggests a comprehensive and general approach to recoverable losses in the market-based approach.

1. The problematic conceptualization of recoverable loss in US securities fraud claims

a. Background: overriding importance of class certification in the class action procedure

431. Certification and class action procedure. – The lack of generally accepted and comprehensible principles delineating recoverable losses in US securities fraud litigation is on the one hand due to the courts' adherence to the traditional – yet in this context often criticized as ill-suited – common law framework[1501], and further exacerbated by the practice settlement that averts the need for courts to appraise the recoverable loss.[1502] More particularly, to bring a successful class action plaintiffs are required to file a motion to have the class certified, which means that the court finds that questions of law or fact common to class members "predominate" over questions affecting individual

[1499] One may argue that in case of bankruptcy, no compensation will be obtained regardless of the conceptualization of loss since the issuer is bankrupt in any case, yet in case other entities or persons contributed or were somehow involved in the fraud, the latter may still be held responsible. If however no loss is suffered at all, no claims are available.

[1500] S.28 (a) SEA 1934 provides that "[n]o person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of the actual damages to that person on account of the act complained of." (15 USC §78bb(a)(1)). Although at the very least very open-ended, both courts and commentators have referred to this provision for support and guidance with regard to the measure of damages to be awarded to the injured party in a rule 10b-5 claim. See also: OLAZÀBAL, 'Loss causation', 358; X., 'Measurement of Damages in Private Actions', (165) 168. Following the enactment of the PSLRA, Congress codified that the burden of proof regarding loss causation lays with the claimant-investors, yet no definition or conceptualization of the recoverable loss as such was provided.[1500]As a result, the delineation of what constitutes a recoverable loss has remained judge-made law regardless of the statutory intervention by the PSLRA. .21D.(b) (4) (Loss causation) SEA 1934 (15 USC § 78u–4 (b) (4) requires that "In any private action arising under this title, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this title caused the loss for which the plaintiff seeks to recover damages." According to the PSLRA, it is thus left to the plaintiff to define the loss suffered following the contravention. Note that liability this contrasts with the codification of the measure of damages to be awarded in the context of deficient prospectuses or registration statements in s.11 and s.12 SA 1933.

[1501] See for instance the acclaimed publication by FISCHEL, 'Use of Modern Finance', 13. For a similar assertion, see the much more recent article by FISCH, 'Cause for Concern', 840, 860; FOX, 'Demystifying Causation', 513 ff.

[1502] See also: B. CORNELL and R.G. MORGAN, 'Using Finance Theory to Measure Damages in Fraud on the Market Cases', 37 *UCLA Law Review*, 1989-1990, (883) 884 and ftn. 5: "[…l few fraud-on-the-market cases have gone to judgment. There is, therefore, little established law on how damages should be calculated for a defrauded class of investors in actively traded securities." See also: ERDLEN, 'Timing is everything', 899; D.P. LEFLER and A.W. KLEIDON, 'Just How Much Damage Did Those Misrepresentations Actually Cause and to whom?: Damages Measurement in "Fraud on the Market" Securities Class Actions', PLI, *Securities Litigation & Enforcement Institute*, New York, Practicing Law Institute, 2005289; S. HAKALA, R. KAPLAN and M. THORSEN, 'Rediscovering the Economics of Loss Causation', 6 *J. Bus. & Sec. L.*, 2006, 113; LEV and DE VILLIERS, 'Stock Price Crashes', 10; RAPP, 'Rewiring the DNA', 4-5. See also: Miller v. Asensio & Co., Inc., 364 F.3d 223, at 228 (4th Cir., 2004).

members.[1503] The FOM-presumption introduced in the Supreme Court decision in *Basic v. Levinson* facilitated class certification as it dispensed the need to establish individualized reliance for each class member[1504], yet other requirements are also needed to establish a successful 10b-5 claim, such as materiality, economic loss and loss causation. However, the question as to whether these requirements have been met, is only assessed by courts at a later stage of the procedure (after class certification) when the merits and the evidence brought forward by the parties are assessed. Since cases generally end up being settled once class certification has been obtained, however, this stadium is generally never reached and the issues to be dealt with after certification has been granted, including the recoverable loss, are left undecided. In the absence of courts discussing and adjudicating the applicable concept and measure of damages, the latter have remained vague and uncertain.[1505]

b. *Out of pocket loss and the price inflation theory*

432. Price inflation-theory. - Lacking statutory guidance, courts have decided on damages on a case-by-case basis, which has led to a "confused area of the law where the courts, forced to rely on their own wits, have created a myriad of approaches", as was eloquently stated by one of the courts confronted by the matter.[1506] Case law and literature indeed rightly note that the confusion on appropriate damages in securities fraud cases have caused courts to indulge a blend of rules and opinions, justified by an assumption that courts have all discretion to fashion damages as they see fit given the particular circumstances of the case.[1507] Overall however, it can be observed that the out of

[1503] Rule 23 (b) (3). See *supra,* ftn. 1396 and 1457.

[1504] Following *Basic*, courts generally granted certification provided that the alleged misrepresentations were publicly made and that the securities at matter were traded in an efficient market.

[1505] T. BAKER and S.J. GRIFFITH, 'How the merits matter: directors' and officers' insurance and securities settlements', 157 *U. Pa. L. Rev.*, 2009, 768 ("Trials are exceedingly rare in securities class actions, and adjudicated outcomes after the motion to dismiss are almost unheard of").

[1506] Koch v. Koch Indus., Inc., 6 F.Supp. 2d 1192, 1201 (D. Kan 1998) quoted in: L.D. LOWENFELS and A.R. BROMBERG, 'Compensatory damages in Rule 10b-5 actions: pragmatic justice or chaos?', 30 *Seton Hall L. Rev.*, 2000, (1083) 1084; and in OLAZÀBAL, 'Loss causation', 358. See on the confusing state of the concept 'economic loss' in the context of rule 10b-5 claims in the US courts also: HAKALA, KAPLAN and THORSEN, 'Rediscovering', 113; A. FERRELL and A. SAHA, 'Forward-Casting 10b-5 Damages: A Comparison to Other Methods', April, 2011, Harvard Law and Economics Discussion Paper, available at SSRN: http://ssrn.com/abstract=1811068, 3, observing that only a handful papers addresses the question of how to properly calculate rule 10b-5 damages and the incoherence, confusion and divergent approaches employed in this regard.

[1507] It is noted that amongst the different measures of damages, the out of pocket-measure, rescissory damages, benefit-of-the-bargain-rule, disgorgement etc. have been applied to assess the damages in given cases. For an overview, see for instance: COX, HILLMAN and LANGEVOORT (eds.), *Securities Regulation*, 725. For an example of disgorgement as the appropriate measure, see for instance Janigan v. Taylor, 344 F.2d 781 (1st Cir. 1965); see in this regard also: Randall v. Loftsgaarden 478 U.S. 647, at 661, 106 S. Ct. 3143, holding that "Courts have also generally applied this out-of-pocket" measure of damages in §10(b) cases involving fraud by a seller of securities […]. But there is authority for allowing the § 10(b) plaintiff, at least in some circumstances, to choose between undoing the bargain (when events since the transaction have not made rescission impossible) or holding the defendant to the bargain by requiring him to pay [out-of-pocket] damages" (internal quotations omitted). For a more recent case, see: Miller v. Asensio & Co., Inc., 364 F.3d 223 (4th Cir., 2004), holding that in the case at matter, the damages were to be measured as the difference between "the fair value of what Plaintiffs received and the fair value of what they would have received had there been no fraudulent conduct at the time of sale" (internal quotations omitted). At the same time, the court considered however that "other damages theories may be appropriate in some situations." The valuable contribution on the topic of EASTERBROOK and FISCHEL dating back to 1985 illustrates that the confusion on the matter was noticed some time ago already, whereas more recent publications on the issue show that the problem and confusion has continued to exists until today. See in this regard: EASTERBROOK and FISCHEL, 'Optimal damages', 611; BURCH, 'Reassessing damages', 348, 361 in particular; J.A. COOPER, 'Rethinking Damages in Securities Class Actions', 48 *Stan. L. Rev.*, 1996, 1487; ERDLEN, 'Timing is everything', 899; OLAZÀBAL, 'Loss causation', 337; FOX, 'After Dura', 847; FOX, 'Demystifying Causation', 513; R.B. LEE, 'The Measure of Damages Under Section 10(b) and Rule 10b-5', 46 *Md. L. Rev.*, 1987, iss. 4, 1266; S. FRANCIS, 'Meet Two-Face: The Dualistic Rule 10b-5 and the Quandary of Offsetting Losses by Gains', 77 *Fordham L. Rev.*, 2009, iss. 6, (3045) 3046; R.B THOMPSON, 'The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages', 31 *Vand. L. Rev.*, 1984, 349 ff.; J. KOSLOW, 'Estimating Aggregate Damages in Class-Action Litigation Under Rule 10b-5 for Purposes of Settlement', 59 *Fordham L. Rev.*, 1991, iss.5, 817; J.C.

pocket-measure has prevailed as the appropriate measure to compensate securities fraud loss in the US courts, though sometimes with some modifications added.[1508] The out of pocket-measure originated in tort law and compensates an injured party for the difference between the price paid and the real value of the purchased item *at the day of the transaction*, or put differently, the market value as it would have been absent the wrongdoer's deceptive action (emphasis added).[1509] In line with this reasoning, various court decisions have held that the injury as a result of the misrepresentation occurs at the moment of the transaction, thereby conceptualizing the price inflation or deflation as such as the recoverable loss (i.e. the difference between T1 and T2 on the curve below).[1510] According to this point of view, the recoverable amount of damages is hence to be measured on the moment of the transaction and equals the price distortion at that point in time.[1511] This approach towards recoverable

ALEXANDER, 'The Value of Bad News in Securities Class Actions', 41 *UCLA L. Rev.*, 1993-1994, (1421) 1428. See also: Myzel v. Fields, 386 F.2d 718, 744 ff. (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968). See on this decision and its considerations regarding the measurement of damages also: X., 'Measurement of Damages in Private Actions', 175.

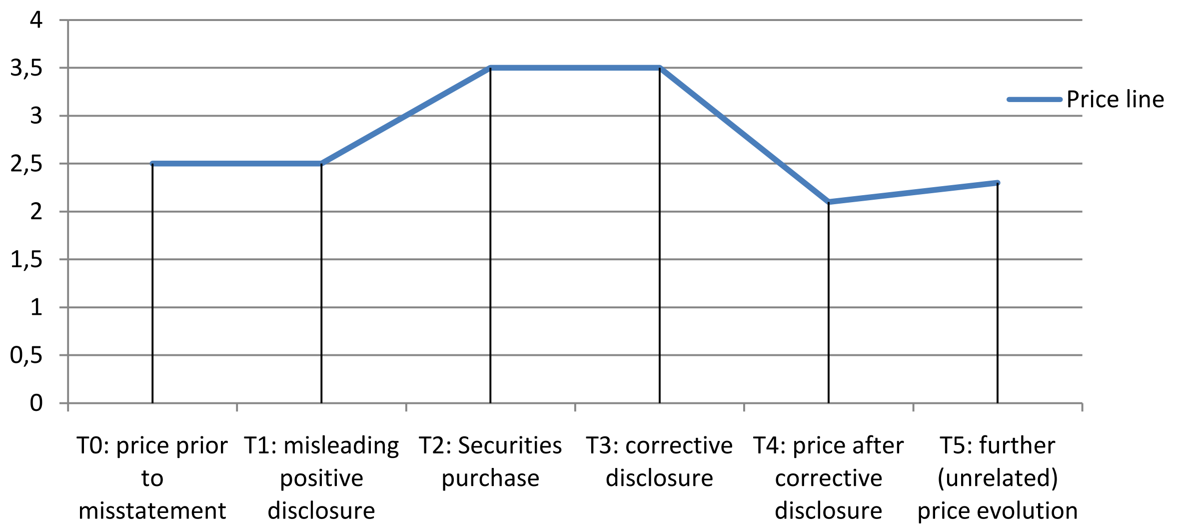
[1508] As repeated at various occasions already, liability claims based on rule 10b-5 have been tailored to resemble the common law tort of deceit by US courts. Unsurprisingly, courts have also adopted the common law out of pocket-loss to compensate for losses claimed following rule 10b-5 contraventions, though with modifications or adjustments depending on the case at hand. See for instance: Lentell v. Merrill Lynch & Co., Inc., 396 F.3d, 161 (2nd Cir.2005) holding that "the tort analogy is imperfect". See also on the use of tort law out of pocket-losses in securities fraud cases: Robbins v. Koger Props., Inc., 116 F.3d 1441, 1447 n.5 (11th Cir. 1997) (citing Huddleston v. Herman & MacLean, 640 F.2d 534, 556 (5th Cir. 1981), aff'd in part, rev'd in part on other grounds, 459 U.S. 375 (1983)); Blackie v. Barrack, 524 F.2d 891, 909 (9th Cir. 1975), cert. denied, 429 U.S. 816 (1976) ("out of pocket loss is the ordinary standard in a l0b-5 suit"); Wool v. Tandem Computers Inc., 818 F.2d 1433, 1437 (9th Cir. 1987); Green v. Occidental Petroleum Corp. 541 F.2d 1335, 1341 (9th Cir. 1976); Estate Counseling Serv., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 303 F.2d 527, 533 (10th Cir. 1962); rather extensively on the calculation of damages in this regard: In re Enron Corp. Securities, 529 F.Supp.2d 644 (S.D.Tex. 2006). See also: LEE, 'Measure of Damages', 1268; ERDLEN, 'Timing is everything', 899; BURCH, 'Reassessing damages', 363; FOX, 'After Dura', 845; THOMPSON, 'Measure of Recovery Under Rule 10b-5', 356; P.J. LEAS, 'Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities', 26 *Stan. L. Rev.*, 1973-1974, (371) 383; KAUFMAN and WUNDERLICH, 'The troubling dispositive role of event studies', 234; LEFLER and KLEIDON, 'Just How Much Damage Did Those Misrepresentations Actually Cause', 289; X., 'Measurement of Damages in Private Actions', 175; KOSLOW, 'Estimating Aggregate Damages', 817.

[1509] *Ibid*. See also: Restatement (Second) of Torts § 549 (deceit): "The recipient of a fraudulent misrepresentation is entitled to recover as damages in an action of deceit against the maker the pecuniary loss to him of which the misrepresentation is a legal cause, including (a) *the difference between the value of what he has received in the transaction and its purchase price or other value given for it; and* (b) pecuniary loss suffered otherwise as a consequence of the recipient's reliance upon the misrepresentation." (emphasis added); Restatement (Second) of Torts § 552B (negligence): "The damages recoverable for a negligent misrepresentation are those necessary to compensate the plaintiff for the pecuniary loss to him of which the misrepresentation is a legal cause, including (a) *the difference between the value of what he has received in the transaction and its purchase price or other value given for it;* and (b) pecuniary loss suffered otherwise as a consequence of the plaintiff's reliance upon the misrepresentation." (Emphasis added).

[1510] See for instance: US: Gebhardt v. ConAgra Foods, Inc., 335 F.3d 824, 831 (8th Cir. 2003): ''Paying more for something than it is worth is damaging"; and at 832: "[T]he plaintiffs were harmed when they paid more for the stock than it was worth"; Myzel v. Fields, 386 F.2d 718, 745 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968), (Myzel v. Fields concerned a securities sale against a deflated price, but states – at p.745 – that with regard to purchases against inflated prices that "the least amount that could be recovered would be the difference between the selling price of the stock and the actual value of the stock *when sold*" (emphasis added, internal quotation omitted)) see on this decision and the considerations regarding the measure of damages also: X., 'Measurement of Damages in Private Actions', 176; Broudo v. Dura Pharms, 339 f.3d 933, 937-938 (9th Cir. 2003), citing Knapp v. Ernst & Whinney, 90 F.3d 1431, 1438 (9th Cir. 1996); Wool v. Tandem, 818 F.2d 1433, 1437 (9th Cir. 1987); Miller v. Asensio & Co., Inc., 364 F.3d 223 (4th Cir., 2004), holding that in the case at matter, the damages were to be measured as the difference between "the fair value of what Plaintiffs received and the fair value of what they would have received had there been no fraudulent conduct at the time of sale" (internal quotations omitted). Note that in this case however the plaintiffs were awarded damages equal to $0.0. since the jury found that the price decline had been caused by other factors than the established misrepresentations. See also the cases cited in: FOX, 'Demystifying Causation', 517, ftn. 41; and LEE, 'Measure of Damages', 1269; EISENHOFER, JARVIS and BANKO, 'Securities Fraud', 1434 ff.; TABAK, 'Loss Causation', 4.

[1511] "[…] it is not necessary that a disclosure and subsequent drop in the market price of the stock have actually occurred, because the injury occurs at the tile of the transaction". Broudo v. Dura Pharms, 339 f.3d 933, 938 (9th Cir. 2003). See in this respect also: FOX, 'Demystifying Causation', 507; EISENHOFER, JARVIS and BANKO, 'Securities Fraud', 1419, asserting that the price inflation theory is consistent with corporate finance theory. See in this regard also: FISCH, 'Cause for Concern', 845.

loss has generally been referred to as the price inflation-theory because it labels the initial price inflation as the focal point to measure loss.



Inflation: disclosure of misleading positive information

433. Whereas some courts consented to this approach with regard to sales against deflated prices, others rejected the price inflation-theory. These courts particularly found that in case securities had been purchased against inflated prices, mere inflation at the moment of the transaction was insufficient to establish loss and loss causation as it renders the pleading standards too broad (see below).[1512] According to these courts, the loss was only suffered once the market realized the deception and reacted by correcting its price.[1513] As a result, these courts have held that in addition to the inflation of the security at matter, a corrective price movement must occur after the market becomes aware of the fraud in order to be entitled to damages (i.e. the price correction following T3 on the graph).

As the preceding paragraph indicates, the discussion on the emergence of recoverable losses in the US courts is not a mere doctrinal discussion, but also involves considerations related to the US procedural system and the pleading standards to pass the certification stage in particular. More particularly, those courts that consider the loss existent at the point of trading at artificially inflated or deflated prices only require evidence of material misstatements that are made available to the public and that relate to securities that are traded in efficient markets. These courts do not require further evidence on the loss

[1512] HAKALA, KAPLAN and THORSEN, 'Rediscovering', 115.

[1513] Amongst others: Semerenko v. Cendant Corp. 223 F.3d 165 (3rd Cir. 2000), stating that "In order to establish loss causation [...] where claimed loss involves purchase of security at a price that is inflated due to an alleged misrepresentation, plaintiff must prove more than purchase of security at an inflated price; plaintiff must also prove that misrepresentation proximately caused decline in security's value"; Lentell v. Merrill Lynch & Co., Inc., 396 F.3d, 161, 173 (2nd Cir.2005) holding that the misstatement or omission must have "concealed something from the market that, when disclosed, negatively affected the value of the security". The mere inflation of the price is insufficient in other words, the loss is caused by the materialization of the concealed risk according to the court; see also: Robbins v. Koger Props., Inc., 116 F.3d 1441, at 1448, in which it was held that the price had indeed been inflated by the misrepresentation, yet the plaintiffs had not suffered any loss causally related to the misrepresentation since "any price inflation due to Deloitte's misrepresentations was still present after October 1990 and, therefore the value the plaintiffs lost was not caused by Deloitte's misrepresentations". The court also held that the mere inflation did not suffice to establish a causal relation between the loss and the misrepresentations, instead "[o]ur decisions explicitly require proof of a causal connection between the misrepresentation and the investment's subsequent decline in value". See also the decisions cited in FOX, 'Demystifying Causation', 518; and EISENHOFER, JARVIS and BANKO, 'Securities Fraud', 1437 ff.

suffered, loss causation or other elements at the class certification phase in the procedure. It is only until in a later stage of the procedure that the question as to the recoverable loss and loss causation is addressed, after the evidence and counterevidence in this regard has been presented and evaluated.[1514] Courts rejecting the price inflation theory on the other hand require indications of losses suffered as a result of the distortion dissipating from the price once the fraud was revealed, which causes the plaintiffs to take this additional hurdle to pass certification and prevent the claim from being dismissed. Put differently, the answer to the question when the (recoverable) loss has emerged, has strategic importance to the parties in the US (procedural) context as it determines the elements that must be proven prior to class certification.[1515] Moreover, since cases are generally settled once certification is obtained, elements that need to be proven after class certification remain generally undecided and bear no relevance to the procedure anymore.

The matter caused the US courts to split over the matter, until a case was brought before the US Supreme Court that provided the latter with an excellent opportunity to resolve the disagreement and set out a sound principles and an appropriate framework to assess the recoverable loss in the context of Rule10b-5 claims. Regrettably, however, the Supreme Court passed a very narrow and limited decision in *Dura*, failing to provide the lower courts with a comprehensive framework and/or more solid guidelines to evaluate and assess losses in FOM-litigation. The decision and its implications are discussed into more detail in the next section.

c. The US Supreme Court's (incomplete) standpoint on recoverable loss and loss causation

i) Facts and decision

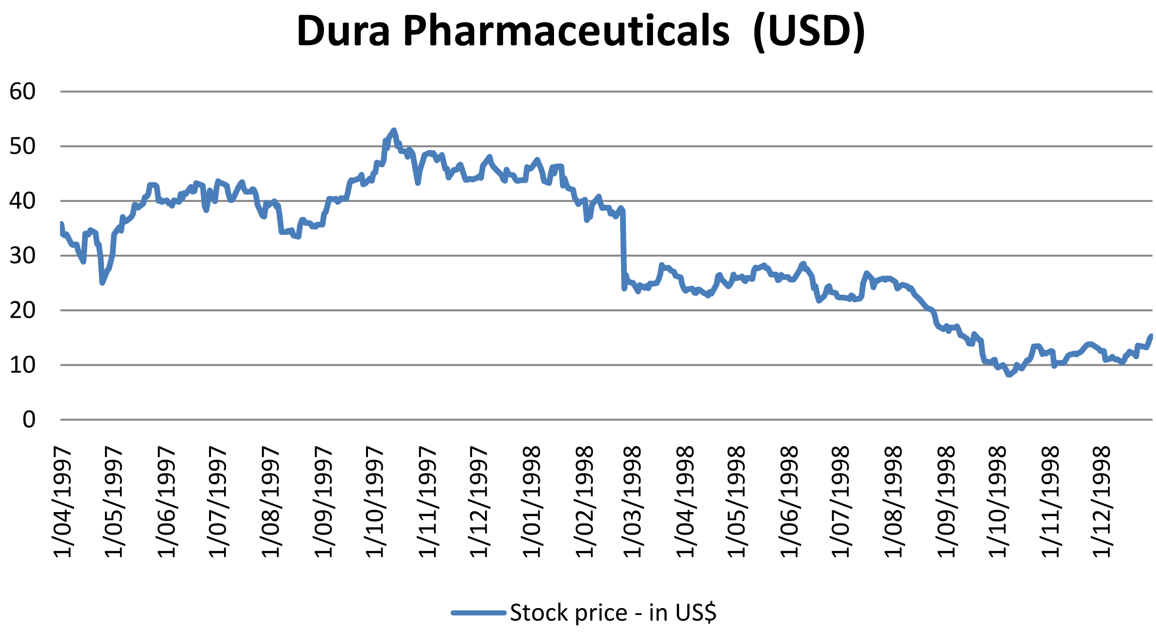
434. In 2005, the Supreme Court resolved the split among the courts in *Dura Pharmaceuticals, Inc., v. Broudo*.[1516] The litigation involved claims relating to misrepresentations on the earnings and information concerning the expected approval of the Food and Drugs Administration ("FDA") with regard to a new delivery device for asthma medication. The series of misrepresentations had occurred between April 1997 and February 1998. In February 1998, Dura announced lower-than-expected earnings due to the slow sale of one of its products. It was later revealed that Dura had been aware of the decline and the lower earnings for a while. In November 1998, news got out that the new device failed approval from the FDA. Whereas Dura's stock price responded to the disappointing earnings with a sharp drop (47 percent decline in one day), there was a more modest reaction to the FDA disapproval (20 percent) followed by a quick recovery of the price.[1517] The plaintiffs argued that since they had purchased the securities at an artificially inflated price as a result of the series of misrepresentations, they had suffered harm consisting of the overpayment at the time of purchasing.

[1514] FOX, 'Demystifying Causation', 522-523. See in this regard also: M.J. KAUFMAN and J.M. WUNDERLICH, The judicial access barriers to remedies for securities fraud, 75 *Law and Contemp. Probs.*, 2012, 55; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 115.

[1515] More extensively: FOX, 'Demystifying Causation', 523-525; COFFEE, 'Causation by presumption?', 533; see on the motivations relating to procedure and policy driving this discussion also: HAKALA, KAPLAN and THORSEN, 'Rediscovering', 93. See also further below, *infra*, para. 440.

[1516] Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005).

[1517] For a summary of the facts of the case, see: P.J. COUGHLIN, E.A. ISAACSON and J.D. DALEY, 'What's Brewing in Dura v. Broudo?', 37 *Loyola University of Chicago Law Journal*, 2005, 10.



435. In its unanimous decision, the Supreme Court rejected this approach and instead held that inflated purchase prices cannot in itself constitute a recoverable loss.[1518] The court particularly held that "as a matter of pure logic", inflated purchase prices cannot in itself constitute a recoverable loss since "the inflated purchase price is offset by ownership of a share that at that instant possesses equivalent value".[1519] As a result, the plaintiff is required to establish proof of a materialized loss after the truth gets known, for instance by showing a depreciation of the shares pursuant to the revelation of the fraud according to the court. However, since stock prices may fall because of a multitude of factors, a mere drop is not sufficient to establish loss causation, it must also be proven that the drop is caused by the realization of the truth and not by other elements, such as general economic or firm- or industry-specific factors.[1520] The court acknowledged that the pleading rules are not meant to impose a great burden on the plaintiff, yet holds that it should not be too much of a burden to provide the defendant with some indication of the loss and the causal connection that the plaintiff has in mind. In other words, although neither economic loss nor loss causation need to be established beyond doubt in the certification stage, some indication of what constitutes the loss and how it relates to the misrepresentation must be provided. As mentioned earlier, the court clearly declared that mere price inflation does not suffice to present such indication.

436. Consequent to *Dura*, lower courts appeared even more confused on the required pleading standards. In *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, the Fifth Circuit for

[1518] Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005).

[1519] "an inflated purchase price will not itself constitute or proximately cause the relevant economic loss"; as a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss; the inflated purchase payment is offset by ownership of a share that at that instant possesses equivalent value", Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005) at 342-343. The court rejected the 'purchase price inflation theory', as it was generally referred to, stating: "Given the tangle of factors affecting price, the most logic alone permits us to say is that the higher purchase price will sometimes play a role in bringing about a future loss. It may prove to be a necessary condition of any such loss, and in that sense one might say that the inflated purchase price suggests that the misrepresentation (using language the Ninth Circuit used) 'touches upon' a later economic loss. […] But, even if that is so, it is insufficient. To 'touch upon' a loss is not to cause a loss, and it is the latter that the law requires." (at 343).

[1520] Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005) at 343. The evidentiary methods and issues related to this requirement are discussed further below.

instance required that the plaintiffs established loss causation by a preponderance of evidence[1521], whereas other courts were inclined to take less demanding positions on the pleading standards.[1522] The matter eventually ended up before the Supreme Court, which unanimously held that plaintiffs need not prove loss causation at the class certification stage, as was the traditional view in this regard.[1523]

ii) Criticism, impact and policy debate

437. Narrowness of the decision in Dura. – Although the US Supreme Court provided an answer to the dilemma splitting the courts, the *Dura*-decision has been criticized from various angles as well. First and foremost, it has been correctly observed that the scope of the decision is very narrow because it only resolves one aspect of the deeper, underlying problem related to the conceptualization of loss causation and recoverable loss.[1524] More particularly, the court explicitly rejected the price inflation-theory, yet failed to provide a broader and more comprehensive framework with a clear vision on what constitutes a recoverable loss, as well as the standards and means to present evidence of such loss.[1525] Although the court mentions the notion economic loss, it does not define it. Although the *Dura*-court was aware of the confusion and uncertainty of what constitutes a recoverable loss and this question in particular, the court considered the matter too hypothetical and refrained from answering the question.[1526] Moreover, considering the issues at stake, the court even declared that it did not need to consider other loss-related questions.[1527]

438. The problem of bunching or bundling. – A second uncertainty left open by Dura relates to the question whether recoverable losses are suffered when the share price after the revelation of the fraud exceeds the initial purchase price, but is still lower than it would have been absent the wrong.

[1521] Oscar Private Equity Investments v. Allegiance Telecom, Inc., 487 F.3d 261, 269 (5th Cir. 2007) (“We hold hence that loss causation must be established at the class certification stage by a preponderance of all admissible evidence.”). For a comment on this decision also: J.R. GUENARD, 'Oscar Private Equity Investments v. Allegiance Telecom, Inc.: The Fifth Circuit Requires Proof of Loss Causation to Trigger the Fraud-on-the-Market Presumption of Reliance', 82 *Tul. L. Rev.*, 20087-2008, 2467. In a similar sense by the same court: Archdiocese of Milwaukee Supporting Fund., Inc. v. Halliburton Co., 597 F.3d 330 (5th Cir. 2010). (“Showing of loss causation is required in order for plaintiff to establish reliance element of Rule 10b-5 securities fraud claim on fraud-on-the-market theory, and at class certification stage, this showing must be made by preponderance of all admissible evidence”).

[1522] Schleicher v. Wendt, 618 F.3d 679, (7th Cir. 2010); labeling the approach laid out by the Fifth Circuit in Oscar Private Equity Investments as a “go-it-alone strategy”; similar: In re LDK Solar Securities litigation, 255 F.R.D. 519 (N.D. Cal. 2009), holding that its approach places the Fifth Circuit in a minority position: see also: In re Salomon Analyst Metromedia Litig., 544 F.3d 474 (2nd Cir. 2008), holding that plaintiffs in a securities class action are entitled to certification when they show that the defendant misrepresented material facts on securities traded in an efficient market, although the defendant is allowed to rebut the FOM presumption at the class certification stage already according to the court.

[1523] Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011). For a more detailed analysis and assessment of this decision, consult: FISCH, 'Trouble with Basic', 895; ERDLEN, 'Timing is everything', 901. See on the requirement to pass certification also: Amgen, Inc, v. Connecticut Retirement Plans and Trust Funds, no. 11-1085, decided February 27, 2013 and holding that materiality needs not proven to pass certification either.

[1524] M.J. KAUFMAN, '26 Securities Litigation: Damages, §11A:11', 2012, Thomson Reuters; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 94, 116; M.B. FOX, 'Understanding Dura', 60 *Bus. Law.*, 2005, 1552.

[1525] Amongst others: FOX, 'After Dura', 847; FISCH, 'Cause for Concern', 824.

[1526] Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005) at 343: “The same is true in respect to a claim that a share’s higher price is lower than it would otherwise have been—a claim we do not consider here.).” Note that the US government, siding with the petitioners (i.e. Dura) in this case, took the standpoint that such losses should be recoverable. Brief for the United States as Amicus Curiae Supporting Petitioners at 7 and at 13, Dura Pharms., Inc. v. Broudo, No. 03-932, available at: 2004 WL 2069564 (Sept. 13, 2004). See on this topic also: KAUFMAN, '26 Securities Litigation: Damages, §11A:11'.

[1527] “In sum, we find the Ninth Circuit’s approach inconsistent with the law’s requirement that a plaintiff prove that the defendant’s misrepresentation (or other fraudulent conduct) proximately caused the plaintiff ’s economic loss. We need not, and do not, consider other proximate cause or loss-related questions”, Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005) at 346.

This scenario may occur in case elements unrelated to the misrepresentation have impacted the price and counter the potential negative reaction following the realization of the misrepresentation. The answer to the question bears considerable importance because a negative answer to the question – implying that a price lower than the initial purchase price is required to be entitled to damages – might have the effect of encouraging dishonest issuers to tie or bundle several announcements which may make up for the negative price movement related to the revelation of the misrepresentation.[1528] Moreover, even if issuers do not engage in such reproachable strategies, referred to as 'bundling' or 'bunching' in the literature, exogenous factors affecting stock prices may cause a similar effect. This problem is acknowledged to cause tensions in the courts especially since Dura clarified that something more than mere inflation is needed, such as a significant drop in price following market realization.[1529] If any potential price drop has been countered by simultaneous announcements or events with an adverse effect on the price, the claim may be haphazardly rejected for lack of a visible price drop, notwithstanding the possibility that the price would indeed have been higher absent the misrepresentation.

439. Dura situated in the policy debate on the need to curb securities class actions. – A final note on Dura concerns the impact of the current (policy) debate on the appropriateness and impact of securities class actions as an instrument to enforce securities laws. Since the notorious *Basic* decision has been delivered, FOM and securities class actions have been the subject or criticism and scrutiny in the courts and literature. Whereas the policy debate on the (lack of) merits of securities class actions debate spawned the enactment of the PSLRA on the legislative level, *Dura* is to some extent the response at the judicial level.[1530] As is apparent from the decision, policy considerations clearly had an impact and were expressly mentioned to support the outcome of the decision.[1531] The debate on the conceptualization of the recoverable loss in courts cannot be considered independent from the particularities of the US procedural system, and the pleading requirements and settlement practice in particular.

440. The policy considerations and justifications raised following the *Dura*-case not only affected court decisions, but also spurred the academic debate on the requirement of causation and loss. In two

[1528] On the phenomenon of bundling or bunching, see for instance:: LANGEVOORT, 'Basic at twenty', 187; J.C. SPINDLER, 'Why Shareholders Want their CEOs to Lie More after Dura Pharmaceuticals', 95 *Geo. L.J.*, 2006, iss. 3 653; BURCH, 'Reassessing damages', 360; FISCH, 'Cause for Concern', 852; FOX, 'Demystifying Causation', 517.

[1529] Although the Supreme Court remains vague on what constitutes a recoverable loss and even states that it is up to the plaintiffs to provide some indication of the loss and the causal connection between that loss and the misrepresentation, the court does clarify that the plaintiffs in Dura failed to allege such loss since they did not claim that the price fell significantly after the truth became known. Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005) at 347. See on this topic also: LANGEVOORT, 'Basic at twenty', 187; SPINDLER, 'Why Shareholders Want their CEOs to Lie', 653; BURCH, 'Reassessing damages', 360; FISCH, 'Cause for Concern', 852.

[1530] FISCH, 'Cause for Concern', 815. With regard to the PSLRA, see also *supra*, ftn. 1412.

[1531] The Dura court explicitly refers to the danger posed by strike suits stating that the price inflation-theory as advanced by the ninth circuit decision "would bring about harm of the very sort the statutes seek to avoid." The court also cites the conference report of the House of Representatives on the enactment of the PSLRA, which criticizes "abusive practices" and "the routine filing of lawsuits . . . with only [a] faint hope that the discovery process might lead eventually to some plausible cause of action "It would permit a plaintiff "with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the [discovery] process will reveal relevant evidence." (citing Blue Chip Stamps, 421 U. S., at 741). "Such a rule would tend to transform a private securities action into a partial downside insurance policy", according to the court which refers to H. R. Conf. Rep. No. 104–369, at 31; see also Basic, 485. Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005) at 347-348. See for similar findings on the attempts carried out by the judiciary to limit the reach and impact of securities class actions also: F.C. DUNBAR and A. SEN, 'Counterfactual keys to causation and damages in shareholder class-action lawsuits', *Wis. L. Rev.*, 2009, nr. 2, 211. HAKALA, KAPLAN and THORSEN, 'Rediscovering', 93.

acclaimed scholarly publications anticipating the Supreme Court *Dura* decision for instance, FOX and COFFEE took opposite views on the proper conceptualization of recoverable loss and loss causation, advancing arguments based on both the substance of the matter as well as the implications and preferred outcome of *Dura* considered from a policy perspective.[1532] COFFEE for instance asserted that the requirement of loss causation – interpreted as the corrective price drop following market realization of the truth – is necessary to preclude "phantom losses" from being recovered.[1533] According to COFFEE, such "phantom losses" may for instance arise in case an investor-plaintiff has purchased securities at an inflated price, yet resold them on the market prior to (complete) market realization of the inaccuracy and thus shifting the overpayment to the next buyer. Arguing in favor of the aforementioned price inflation-theory, FOX, however, argued that the strict loss causation requirement as advanced by COFFEE was unnecessary to invalidate this kind of 'phantom' losses because plaintiffs are always required to present evidence of alleged losses.[1534] If the investor claimant resells those securities that have been purchased against an inflated price before market realization and a corrective price drop occurred, no recoverable loss in the sense of rule 10b-5 has been suffered by that investor, according to FOX. Both scholars agree in other words that in case of resale prior to any correction and hence against an inflated price, no recovery should be awarded.[1535]

The difference between these two opinions does not concern the concept of recoverable loss as such in other words, but instead relates to the procedural implications of the position taken in the light of the US procedural framework governing class actions.[1536] More particularly, if one requires plaintiffs to sketch the contours of the loss and causal relation between the alleged loss and the misrepresentation in terms of a price reaction following market realization in the certification phase already, a stricter standard is employed to pass class certification. In case the matter is however dealt with as a question of (individual) damages, the matter only becomes relevant at trial when deciding on the merits, as FOX postulates.[1537]

441. However, since most securities class actions are settled following certification, these cases are rarely considered and judged on their merits, depriving the matter from any relevance in practice. COFFEE asserts that the approach as advanced by FOX is therefore bound to result in (even) more securities class actions passing the certification bar and therefore denounces dispensing from the loss causation requirement.[1538] FOX on the other hand advocates that a strict loss causation requirement would inappropriately cut out credible and meritorious claims to the detriment of truly injured investors.[1539] In the aftermath of *Dura*, it has indeed been observed that the requirement to show an

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[1532] FOX, 'Demystifying Causation', 507; COFFEE, 'Causation by presumption?', 533. See on the motivations relating to procedure and policy driving Dura also: HAKALA, KAPLAN and THORSEN, 'Rediscovering', 93 ("The apparent struggle in securities fraud cases to identify when a relevant loss has occurred is based on 1) confusion of terminology; 2) failure to appreciate or accept the economics underlying the efficient market hypothesis; *3) concerns about the nature of the evidentiary proof of loss; and 4) concerns that the scope of potential liability is unfairly broad and must be minimized in every reasonable way*.") (emphasis added).

[1533] COFFEE, 'Causation by presumption', 533.

[1534] FOX, 'Demystifying Causation', 522.

[1535] Whereas both scholars consent that in this hypothesis of a resale prior to (full) market realization investors do not suffer losses, COFFEE deems the ninth circuit decision in *Broudo v. Dura Pharms* not entirely clear in this respect. COFFEE, 'Causation by presumption?', 538.

[1536] *Ibid*. 539; and FOX, 'Demystifying Causation', 522-523. See in this regard also: KAUFMAN and WUNDERLICH, 'Judicial access barriers', 55; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 115.

[1537] FOX, 'Demystifying Causation', 522-523. See also the references cited in the previous footnote in this regard.

[1538] COFFEE, 'Causation by presumption', 540 ff.

[1539] FOX, 'Demystifying Causation', 522-523.

indication of loss and loss causation in the certification stage has resulted in a 'battle of the experts' over factual matters that usually exceed the pleading requirements and instead concern the merits of the case.[1540] In line with COFFEE's concern however the *Dura*-court observes that the price inflation-theory is likely to enhance abusive suits and "transform a private securities action into a partial downside insurance policy".[1541]

442. The discussion set out in the preceding paragraphs allows for the conclusion that the conceptualization of recoverable losses in US rule 10b-5 claims remains unsettled and uncertain. *Dura* essentially dispensed with the price inflation-theory, partially because of the finding that loss only materializes when the market has become aware of the misrepresentation, and partially because of policy considerations regarding the procedural implications of the position taken in the debate, as illustrated by the acclaimed academics mentioned. Overall, the result of *Dura* seems limited to the holding that mere overpayment does not suffice to be entitled to damages, a price reaction upon realization of the misrepresentation is required as well. How this requirement plays out in more complicated settings when various announcements or evolutions unrelated to the misrepresentation have taken place has been deliberately left open and remains thus uncertain.

443. The discussion also highlighted the Supreme Court's acknowledgment of and compliance with the congressional efforts made to limit the impact of securities class actions based on policy considerations. The debate stressed that the real matter at stake instead lies with the procedural implications of the various positions taken and illustrates the need to consider the particularities of each jurisdictions within its proper context. More important to our research however is the conclusion that the aforementioned academic discussion revealed that – regardless of the position taken – it is in fact uncontroversial and generally accepted that investor-claimants who recouped inflated purchase

[1540] KAUFMAN for instance points out that event studies carried out by experts to determine whether or not the misrepresentation has caused the loss the investors claim to have suffered have become a standard requirement in the pleadings, which is excessive in this stage of the procedure and even unconstitutional according to the author. KAUFMAN and WUNDERLICH, 'The troubling dispositive role of event studies', 183. The decision in *In re Vivendi Universal, S.A. Securities Litigation*, No. 02 Civ. 5177, 2009 WL 1066254 illustrates the central role event studies have come to play, holding that: "Once an event qualifies as a materialization of the risk, plaintiffs must still prove that their losses were caused by that event. […] It is an expert that produces the *almost obligatory* (emphasis added) "event study" that begins by isolating stock declines associated with market-wide and industry-wide downturns from those specific to the company itself." See in this regard also: M. ALEX and M.W. STOCKER, 'Role of the event study in loss causation analysis', 242 *NY Law Journal*, 2009, August 20, no. 36.

[1541] Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005) at 347-348; noting that the price inflation-theory as advanced by the ninth circuit decision "would bring about harm of the very sort the statutes seek to avoid." The court even cites the conference report of the House of Representatives on the enactment of the PSLRA, which criticizes "abusive practices" and "the routine filing of lawsuits . . . with only [a] faint hope that the discovery process might lead eventually to some plausible cause of action". See: Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005) at 347 and H. R. Conf. Rep. No. 104–369, p. 31 (1995). The tendency to curb securities class actions supported by policy considerations was not uniquely visible in Dura, but also surfaced in other Supreme Court decisions. In Stoneridge for instance, the Supreme Court rejected an expansion of the FOM-doctrine to (secondary) defendants who aided and abetted to defraud the investment public. To support its point of view, the Supreme Court for instance held, among other things, that "[t]he practical consequences of an expansion […] provide a further reason to reject petitioner's approach. In Blue Chip, the Court noted that extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies. […] Adoption of petitioner's approach would expose a new class of defendants to these risks. […] Contracting parties might find it necessary to protect against these threats, raising the costs of doing business. […] Overseas firms with no other exposure to our securities laws could be deterred from doing business[…] This, in turn, may raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets." Stoneridge Investment Partners v. Scientific-Atlanta, 552 US 148 (2008), at 163-164. See on this decision and the policy considerations taken into account to reach its outcome: N. WANEKA, 'Stoneridge Investment Partners v. Scientific-Atlanta: Rethinking the Fraud-on-the-Market Presumption and the Policy Considerations Permeating the Court's Decision', 86 *Denv. U. L. Rev.*, 2008-2009, 303; B. BLACK, 'Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., (8th Cir. 2006). What makes it the most important securities case in a decade?', 2007, U. of Cincinnati Public Law Research Paper No. 07-21. Available at SSRN: http://ssrn.com/abstract=1020102, 17p.

prices by a timely resale cannot be entitled to damages. In the text below, we examine the conceptualization of recoverable loss in the market-based approach as its stands in the EU Member States acquainted with the concept, and compare to the US framework whenever relevant.

2. The German concept of mispricing damages compared and evaluated: tentative conclusions

444. It should be noted from the outset that the German Supreme Court has only recently endorsed the concept of mispricing damages ('*Kursdifferenzschaden*') in addition to the traditional rescissory measure ('*Naturalrestitution*'). Although the limited amount of available decisions offer some indications on the concept of mispricing loss, further development in the case law is needed. The analysis in the following is thus highly tentative and to be treated with appropriate reservations and caution as the concept of mispricing damages will undoubtedly continue to develop in the near future. Any conclusions or comparisons drawn with its US counterpart are equally prone to adjustments in the light of future case law. With these reservations in mind, some tentative observations with regard to the German Supreme Court's vision in recoverable losses are worth mentioning already.

445. According to the wordings employed in its recent IKB-decision, the BHG appears to conceptualize the recoverable loss differently in comparison to the US Supreme Court.[1542] Instead of centering the concept of recoverable loss on the decline in price following corrective disclosures or market realization of the distortion, the German Supreme Court focuses on the price inflation (or deflation) following the misrepresentation *at the moment of the transaction*.[1543] Whether this will lead to a (considerably) different result compared to the US approach does not seem very likely however in the light of the current case law and prevailing opinions in the literature. Even though the German Supreme Court seems to adopt a concept of recoverable loss in line with the price inflation-theory at first sight, various elements indicate that a similar outcome may be reached in practice.

446. First, contrary to the US, the German legislator has provided guidelines with regard to the situation in which an investor-claimant has resold the securities at matter prior to (full) market realization of the truth. The preparatory documents drafted for the enactment of §§37b, c WpHG

[1542] "[…] er muss lediglich darlegen und gegebenenfalls beweisen, dass – wäre die Ad-hoc-Mitteilung rechtzeitig erfolgt – der Kurs zum Zeitpunkt seines Kaufs niedriger gewesen wäre"; BGH, 13 December 2011, XI ZR 51/10, (IKB), *ZIP* 2012, 318 and available: http://juris,.bundesgerichtshof.de, para. 67 in particular. Similar: BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV) at 1274 ("Der Differenzschaden in Form des Unterschiedsbetrages zwischen dem tatsächlich gezahlten Transaktionspreis und dem Preis, der sich bei pflichtgemäßem Publizitätsverhalten gebildet hätte, ist entgegen der Ansicht des Berufungsgerichts grundsätzlich ermittelbar."). The BHG hence adopts the prevailing view as expressed in the academic literature in this regard. See for instance: MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§37b, c, para. 244, para. 341 and 345 ("[…] auf Ersatz der Differenz zwischen dem tatsächlich bezahlten bzw. erlösten Transaktionspreis und dem Preis, der sich bei pflichtgemäßen Publizitätsverhalten zum Zeitpunkt der Transaktion gebildet hätte"); MÜLBERT/STEUP in HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 195 ("Der Vermögensschaden des Anlegers liegt in der Differenz des tatsächlichen Erwerbs- bzw. Verkaufspreises und dem hypothetischen Preis des Wertpapiers hat pflichtgemäßen Publizitätsverhalten des Emittenten zum Zeitpunkt der Transaktion"); SETHE in ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §§37b, c, para. 79; C. SCHÄFER, M. WEBER and P. WOLF, 'Berechnung und Pauschalierung des Kursdifferenzschadens bei fehlerhafter Kapitalmarktinformation', *ZIP* 2008, heft 5, 198, 202; BARTH, *Schadensberechnung*, 214; CASPER, 'Significance of the Law of Tort', 102. In a similar sense: KLÖHN, 'Die Haftung wegen fehlerhafter Ad-hoc-Publizität', 357. See in the US literature for a similar point of view: FOX, 'Demystifying Causation', 507, 520 ff. in particular. France: SPITZ, *La réparation*, 267-269, para. 430. Austria: SCHOBEL and PARZMAYR, 'Anlegerschaden und Schadensberechnung', 174.

[1543] Compare also with the (French) Paris Court of Appeal decision in SG de Fonderie, stating that the loss is certain as soon as the investor-claimants purchase securities against a price exceeding the real value of the securities as a result of misrepresentations. CA Paris, 9th Ch., 15 January 1992, (*SG de Fonderie*), JurisData: 1992-020282; *Dr. sociétés*, 1992, §189, comment by H. HOVASSE; *RTD com*., 1992, 884, comment by P. BOUZAT ("[…] la certitude d'un tel préjudice est acquise, dès lors que les victimes ont acheté des actions « S.G.F. » à un cours supérieur à leur valeur réelle et ce par suite de la diffusion de fausses informations ou des informations trompeuses […]").

unequivocally hold that only investor-claimants who initially purchased against inflated prices and have remained in possession of the securities at matter are eligible to file claim.[1544] Similarly, with regard to deflated prices it is held that only those investors who purchased the securities prior to the misrepresentation and sold (against deflated prices) before the truth got out are entitled to recovery. Regardless of the conceptualization of the recoverable loss by the courts in other words, the legislator has provided the framework within which damages can be claimed, reaching a result highly similar to the US approach in this particular aspect.

447. Secondly, although the literature considers that the recoverable loss is constituted by the initial price inflation or deflation, it also indicates that to assess the extent of the loss, the correction of the market price following the announcement or realization of the misrepresentation serves as a relevant indication of the scope of the loss.[1545] Whereas a price adjustment consequent to market realization of the truth is thus not formally required to claim a recoverable loss, it may be taken into account to provide evidence of the price distorting effect of the misrepresentation as well as the scope of the distortion. Similarly, to the extent the price remains unchanged after the market became aware of the deception, courts may be inclined to conclude that the inflation or deflation was minimal to inexistent. Moreover, in case mere omissions of information affect securities prices, yet not in a manner that is readily observable at the moment of the transaction, price reaction to the disclosure of the omitted information may serve as the focal point by lack of other indications, as KLÖHN points out.[1546] Additionally, according to the relevant (finance) literature on the topic, in the light of the statistical method to measure the damages, referred to as event analysis and discussed into more detail further below, price reactions to the announcement of misrepresentation (ex post) are considered more appropriate to use as focal point.[1547] For these reasons, price reaction following market realization bears relevance, regardless of the conceptualization of recoverable loss.[1548] Finally, it is once more stressed that the German Supreme Court has only recently adopted the possibility of claiming *Kursdifferenzschaden*, rendering the comparison very tentative and subject to further development and implementation by the German courts.

[1544] "Im Falle einer unterlassenen unverzüglichen Meldung, die geeignet ist, den Kurs negativ zu beeinflussen, folgt eine Schadensersatzpflicht aus Absatz 1 Nr. 1. Anspruchsberechtigt ist hier derjenige Anleger, der nach dem Zeitpunkt, zu dem eine ordnungsgemäße Veröffentlichung hätte erfolgen müssen, die Wertpapiere des pflichtwidrig handelnden Emittenten erwirbt und im Augenblick des Bekanntwerdens der Tatsache noch Inhaber der Papiere ist."Begründung zum Regierungsentwurf 4. Finanzmarktförderungsgesetz, in: Gesetzentwurf der Bundesregierung (Regierungsentwurf) zur weiteren Fortentwicklung des Finanzplatzes Deutschland (Viertes Finanzmarktförderungsgesetz), BT-Drucks. 14/8017, 18 January 2002, available at: http://dip21.bundestag.de, p. 93 ff.

[1545] Amongst others: CASPER, 'Significance of the Law of Tort', 102; MÖLLERS/LEISCH in HIRTE and MÖLLERS (eds.), *Kölner Kommentar zum WpHG*, §§37b, c, para.347; SETHE in ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §§37b, c WpHG, para. 79; MÜLBERT/STEUP in HABERSACK, MÜLBERT and SCHLITT (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, §33, para. 204; MAIER-REIMER/PASCHOS in HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §29, para. 138; SCHÄFER, WEBER and WOLF, 'Berechnung und Pauschalierung des Kursdifferenzschadens', 198 and 202 in particular; RICHTER, *Schadenszurechnung*, 99; HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 138.

[1546] KLÖHN, 'Die Haftung wegen fehlerhafter Ad-hoc-Publizität', 357. Also signaling the problem of measuring price distortions in case of omitted or delayed disclosures in the US context: FISCH, 'Trouble with Basic', 921.

[1547] FISCH, 'Trouble with Basic', 922; ALEX and STOCKER, 'Role of the event study', . See also: EASTERBROOK and FISCHEL, 'Optimal damages', 626-627, holding that the overpayment on the moment the misrepresentation occurs, can often not be determined and hence suggesting that the appropriate method is to measure the drop, provided that "a technology that permits us to "take out the market,"" is used. This technology is elaborated on further below.

[1548] Similar: KLÖHN, 'Die Haftung wegen fehlerhafter Ad-hoc-Publizität', 357.

3. Recoverable damages following wrongful price distortion: unsettled matters in the UK and the Netherlands

448. It was mentioned already that the market model has been acknowledged in other Member States as well. In the Netherlands, the Dutch Supreme Court adopted a rebuttable presumption of transaction causation with regard to prospectus liability claims. Although it is uncertain whether the line of reasoning employed regarding prospectus liability may be extended to secondary market transactions, the court briefly remarks that with regard to secondary market purchases (following the deficient prospectus information) it should be assumed that these purchases would have taken place under different conditions absent the wrong.[1549] The assumption that the transactions would have taken place under different conditions should allow a plaintiff to obtain damages equal to the price distortion caused by the wrong.[1550] No further clarification was provided however, nor has the matter been taken up in other decisions that might have offered significant insight into the contours of the concept of recoverable damages in this regard.[1551] Similarly, compensation for losses due to mispricing have been advanced as the appropriate approach to losses suffered following deficient prospectuses under s.90 FSMA in the UK, although no decisions have yet been reported offering insights on the interpretation and application of this concept of recoverable damages in the UK courts.[1552]

4. Assessment and proposed solution with regard to the conceptualization of recoverable loss

449. The comparative overview in the preceding paragraphs allows for the conclusion that the current state of play with regard to mispricing losses in EU Member States leaves considerable room for further development. Taking the insights from the US discussion into account, the text below offers an assessment, consideration and suggestions for the further development of a fitting concept of recoverable mispricing loss following misreporting on secondary markets in EU Member States.

a. Recoverable transactions

450. Recoverable losses in the market model are losses resulting from transactions that have been carried out against distorted (i.e. inflated or deflated) prices following a misrepresentation that affected the price. It is hence essential that the investor carried out the offending transaction(s) *after* the violation took place. To the extent no transaction has been carried out (decision to hold) or to the

[1549] HR 27 November 2009, *JOR*, 2010/43 with annotation by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht* 2010, 21, with annotation by H.M. VLETTER-VAN DORT, r.o. 4.11.2.

[1550] DE JONG, 'Liability for Misrepresentation', 365. The author also notes that this approach is likely to have an impact on the calculation of damages, but does not elaborate on the topic since it has not yet been settled under Dutch law.

[1551] In this regard reference should be made to the decision handed down by the Utrecht Court of First Instance concerning losses allegedly suffered by the investor-claimants following misleading press releases relating to the financial position of the issuer. The claims are directed against both the bank and several members of the management team of the bank allegedly responsible for the misrepresentations. Considering the requirements of causation and damages, the court particularly stated that the investor-claimants had submitted motivated statements of having suffered loss due to price distortions as well as distorted investment decisions (including decisions to hold the securities instead of selling them). Interestingly, the court briefly mentions that it is a real possibility that the investors may have held or purchased securities as a result of the misrepresentations, yet does not mention losses suffered as a result of price distortions again. Whether the requirements of loss and causation are fulfilled is not decided by the court. A specific and separate procedure aimed at the determination of these matters will be carried out. Utrecht, Rb Utrecht, 15 February 2012, *Ondernemingsrecht* 2012, 267, with annotation by B. DE JONG; *JOR* 2012/243, with annotation by J.H.M. WILLEMS; C.R. JACOBS, 'Rechtbank Utrecht inzake Fortis: misleidende mededelingen, koersgevoelige informatie en bestuurdersaansprakelijkheid', *V&O* 2012, nr. 6, 116.

[1552] See on this topic: ALCOCK, 'Misinforming the market', 251.

extent the transactions took place *before* any contravention occurred, no recoverable loss arises according to the market model.[1553] Furthermore, amongst the recoverable transactions according to this model, two different types of harmful transactions can be distinguished. On the one hand, the investor suffers harm when selling securities against a deflated price, implying he is selling 'too cheap' because of the wrong. The second type of recoverable transactions involves the purchase of securities at an inflated price as a result of the misstatement (paying too much), provided that the investor-claimant has remained in possession of the securities at least until the truth became known, either partially or entirely. Both situations are discussed into more detail in the following.

451. Purchase following misleading positive disclosure or omitted negative disclosure (price inflation). – In case an investor purchases securities following misleading positive disclosures or omissions of negative information, the transactions are carried out against inflated prices. Whether the inflation is the recoverable loss as the aforementioned price inflation theory holds, or whether the loss only arises after the inflation dissipates following corrective disclosures and/or market realization has been the subject of debate in the US. Regardless of which point of view is taken on the conceptualization of the loss however, it was found that the various theories essentially boil down to the recovery of price inflations to the extent the investor-claimant has not recouped the inflationary part of the price by a consecutive sale *before* the market realized the misrepresentation and corrected the prices.[1554]

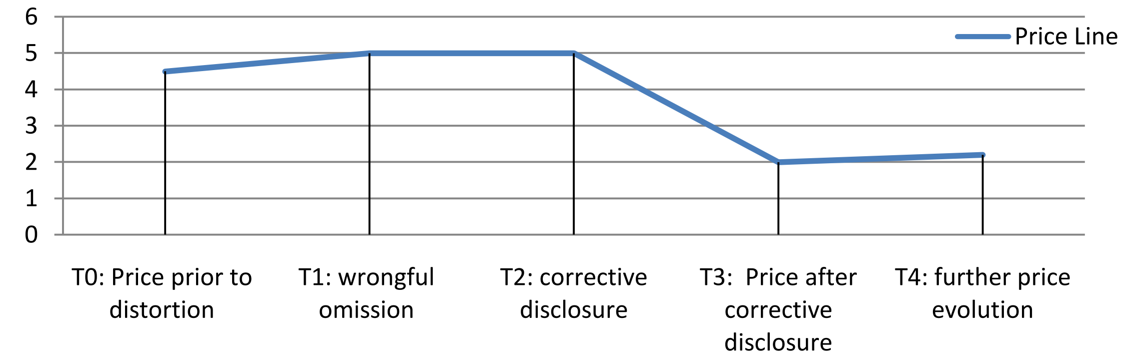
452. Summarized, it can be concluded that the recoverable loss is caused by an initial overpayment due to the defendant's misrepresentation(s), yet it remains latent and only materializes when the investor can no longer recover that overpayment in the market.[1555] As long as the inflation has not dissipated however, there is a risk of future harm, but it is only pursuant to dissipation of the inflationary part that latent harm materializes. The prevailing view in literature holds that the emergence of mere risks due to wrongful behavior, yet without the occurrence of actual harm as the risk materializes, is not recoverable.[1556]

[1553] Similar conclusion drawn by SPITZ discussing losses following affected transaction conditions ('prejudice de conditions'): SPITZ, *La réparation*, 278, para. 248.

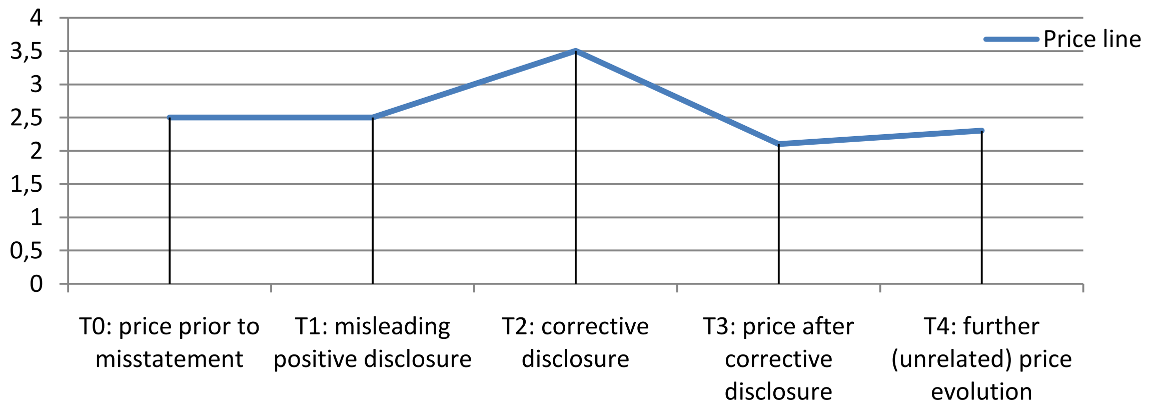
[1554] It was already observed that the discussion on the price inflation-theory vis-à-vis the loss causation-standpoint as defended by acclaimed academics as FOX and COFFEE fundamentally concerned the procedural implications triggered by the approach used in the context of (securities) class action procedures. Regardless of the approach advanced, both academics agreed on the need to establish evidence of the economic harm suffered, but differed in opinion on when this should be done from a policy-perspective, considering the procedural positions of both parties involved. In the German framework, courts seem to have defined the recoverable loss also as the overpayment at the moment of the transaction, yet it is clarified in the preparatory documents that investor-claimants are entitled to recovery only in case they have retained the securities at least until the truth came out. See *supra*, para. 440

[1555] FOX, 'Demystifying Causation', 522; ERDLEN, 'Timing is everything', 885; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 96 ff.; similar: EISENHOFER, JARVIS and BANKO, 'Securities Fraud', 1443. E. BRUEGGER and F. DUNBAR, 'Estimating Financial Fraud Damages with Response Coefficients', 2009, (NERA), available at SSRN: http://ssrn.com/abstract=1438256 or http://dx.doi.org/10.2139/ssrn.1438256 p. 4: "[…] the measure of economic loss per share is the inflation per share at purchase less inflation per share at sale"; KAUFMAN, '26 Securities Litigation: Damages, §11A:11'; CORNELL and MORGAN, 'Using Finance Theory', 886; DUNBAR and SEN, 'Counterfactual keys', 219-221. See in this regard also: (Germany) SCHÄFER, WEBER and WOLF, 'Berechnung und Pauschalierung des Kursdifferenzschadens', 198; WAGNER, 'Schadensberechnung', 522-523.

[1556] With regard to the US: Fisch, 'Cause for Concern', 852-860; contingent losses are not recoverable under UK tort law either: Forster v Outred & Co, [1982] 2 All E.R. 753 ("If…the English decisions properly understood support the proposition that where, as a result of the defendant's negligent representation, the plaintiff enters into a contract which exposes him or her to a contingent loss or liability, the plaintiff first suffers loss or damage on entry into the contract, we do not agree with them. In our opinion, in such a case, the plaintiff sustains no actual damage until the contingency is fulfilled and the loss becomes actual; until that happens the loss is prospective and may never be incurred."); and *Law Society v Sephton & Co* [2006] UKHL 22 ("A contingent liability is not as such damage until the contingency occurs"). The question when and under what



Inflation: Omission of (negative) market disclosure



Inflation: disclosure of misleading (positive) information

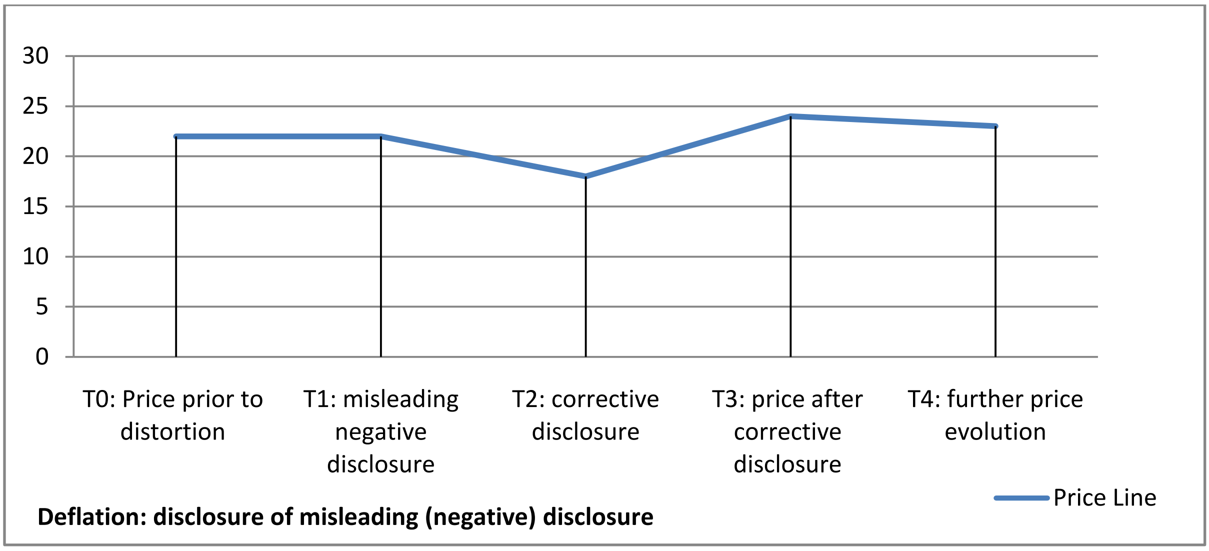
453. The most frequent occurring event causing the loss to materialize is obviously market realization. Dissipation of price inflation may occur as a result of corrective disclosures issued by the issuer or other market participants, the media, or even rumors. Another manner for the market to become aware of the misrepresentation is obviously through the materialization of an undisclosed risk.[1557] Market realization may occur in a single instant, for instance following a corrective disclosure revealing the (entire) truth, or it may gradually establish over time following consecutive disclosures or events. To the extent the market does not become aware of the full scope of the deception at one single moment but instead only realizes the full extent over a prolonged time span, the impact of the news is harder to assess and may complicate the assessment of the loss, as will be seen further below. Whereas most authors and/or courts seem to focus on market realization as the relevant point in time

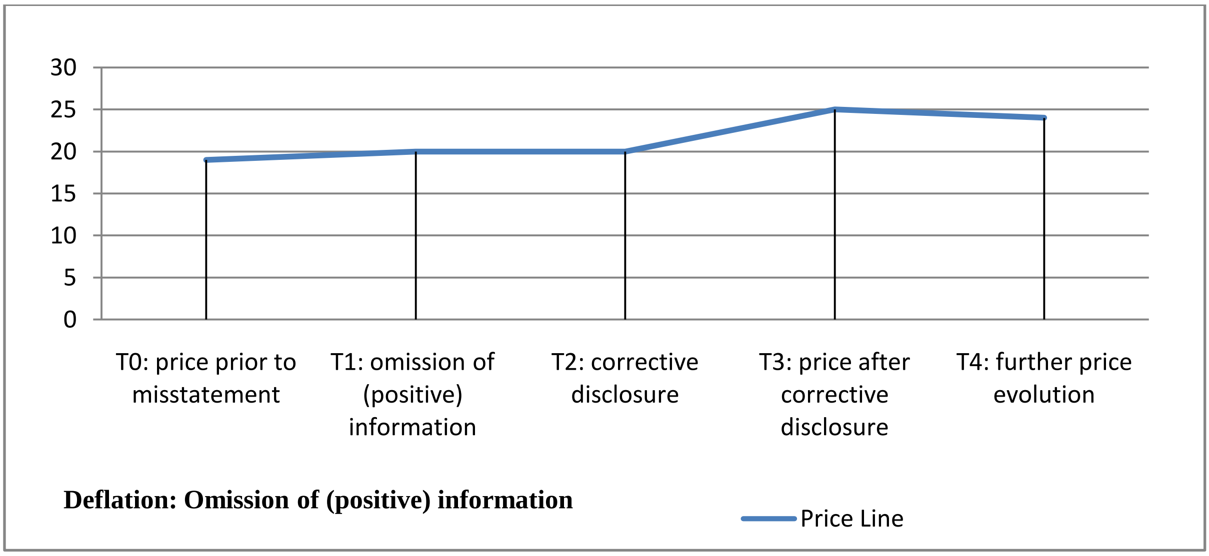
conditions a loss is contingent is often more difficult to determine however. On the required certainty of the emergence of the loss, hypothetical, virtual and potential losses see with regard to Belgium: RONSE, *Schade en schadeloosstelling*, 75, para. 94 ff. in particular; France: LE TOURNEAU, *Droit de la responsabilité et des contrats*, 556, para. 1414 in particular. See also: SPITZ, *La réparation*, 224. The latter considers the approach according to which the loss emerges at the moment of the transaction rather theoretical. See also, *supra*, Part I, Chapter III, para. 137.

[1557] See more extensively on the disclosure mechanisms triggering price corrections: ERDLEN, 'Timing is everything', 907; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 101.

for the loss to materialize, it should be noted that other kinds of events may cause a similar result, such as the company's bankruptcy to name one.[1558]

454. Sale following deceptive negative information disclosure or omitted positive disclosure (price deflation). – A second type of situation in which investors may suffer losses as a result of price distortions concerns the situation in which they sold securities against deflated prices. In order to be entitled to recovery, investors must have acquired the securities prior to the occurrence of the deflation and effectuated the sale during the deflation period.[1559] It follows from this concept of loss that harm is material as soon as the investor is confronted with the impossibility to recoup the price difference caused by the misrepresentation. Once the distortion has dissipated, the harm is suffered and renders the question of whether the investor has remained in possession of the securities at matter irrelevant.[1560]





[1558] See for an example: KAUFMAN and WUNDERLICH, 'The troubling dispositive role of event studies', 238-239 and the reference cited in ftn. 356. See on this situation also: HAKALA, KAPLAN and THORSEN, 'Rediscovering', 107; TABAK, 'Loss Causation', 11.

[1559] Similar: SCHÄFER, WEBER and WOLF, 'Berechnung und Pauschalierung des Kursdifferenzschadens', 198.

[1560] See also: DE JONG, *Schade door misleiding*, 178-179; SPITZ, *La réparation*, 236, para 380 ff.; *Contra*: MAGNIER, 'Information boursière et préjudice des investisseurs', 558.

b. Recovery possible where share price exceeds purchase price and the prevention of 'bundling' or 'bunching' practices

455. One of the questions left open by the US Supreme Court in the aforementioned *Dura* decision concerned the question whether recoverable losses could arise when the share price (as it stands after a corrective disclosure has been made) exceeds the initial purchase price but is still lower than it would have been absent the wrong as a result of intervening, exogenous elements. The same question arises when securities traded after the truth came out are sold for a price lower than the (deflated) price against which the investor-claimant sold the securities. These scenarios may occur in case elements unrelated to the misrepresentation affect the prices, covering up for the adverse movement following market realization of the deception.

Although the Supreme Court did not provide an answer in the *Dura* decision, other courts have pondered on the question. In an influential concurring decision in *Green Petroleum* for instance, judge SNEED pointed out that recovery in cases where the sales price (or residual value in case no sale has occurred yet) exceeds the purchase price should be available if it can be proven that but for the wrong, the sales price (or residual value) would have been higher.[1561] Again, this logically follows from a consistent application of the '*Differenzhypothese'* according to which the negative difference between the situation as it would have been absent the wrong, and the actual situation including the wrong, is recoverable to the injured parties. Not the initial purchase or sale price should be used as a benchmark, but instead the hypothetical price on the reference date as it would have been without the wrong.

456. The relevance of a correct reference point is illustrated by the following example. Assume that a company issues erroneous and overly optimistic forecasts, inflating the price from €70 to €76. After two months, the price has been influenced by topical news, but has not dramatically changed in value (assume €73). Then suppose that the issuer announces to have concluded profitable contracts, driving up the prices (with €10 per share) while at the same time announcing that the earlier forecast might have been overstated and are corrected downwards. Although the latter has a downward effect on the price (€6/share), the share price still exceeds the initial purchase price (€77) as a result of the positive news. Whereas the claimant-investor overpaid €6 and has not recovered his overpayment, he has no claim under the *Dura*-rule requiring a price drop. Yet without the inflation, the investor-claimant would have gained a net of €7 on the investment, whereas he only gains €1 in the given circumstances. Taking the reasoning one step further, the requirement of the price drop encourages dishonest issuers to bundle disclosures in order to prevent the price from dropping below the initial level and get away with the misrepresentation without further ado.[1562] This practice has been referred to as 'bundling' or 'bunching' in the US literature and is acknowledged to cause tensions between the tort concept of damages and the lower courts' interpretation of *Dura*.[1563] In case recovery is allowed for losses

[1561] Green v. Occidental Petroleum Corp. 541 F.2d 1335, 1346 (9th Cir. 1976).

[1562] Similar: LANGEVOORT, 'Basic at twenty', 187; SPINDLER, 'Why Shareholders Want their CEOs to Lie', 653; BURCH, 'Reassessing damages', 360; FISCH, 'Cause for Concern', 852.

[1563] It is stressed that the Supreme Court has not confirmed this interpretation of loss causation, the decision in *Dura* simply does not answer the question clearly, leaving it to the lower courts to decide the matter. In the lower courts however, the Dura decision appears to have been interpreted as requiring a price drop following corrective disclosures at various occasions already, such as: In re Veeco Instruments Inc. Securities Litigation 2007 U.S. Dist. No. 05 MDL 0165(CM), Nov. 7, 2007: "Plaintiffs were constrained in their ability to prove that certain Class members had been damaged, in light of this Court's June 28, 2007 ruling on one of Defendants' motion *in limine,* which held that Plaintiffs' damages calculations could not include Class Members who purchased Veeco stock during the Class Period and either sold it at a profit, or retained it past the point after the Class Period when the stock price first recovered to the price at which the shares were purchased. This is suffered regardless of whether they surpass the initial purchase or sale price or not, 'bundling' or 'bunching' practices may lose (some of) their appeal.[1564]

B. The calculation of damages: methodology

1. Overview: the need for verifiable methods to calculate losses resulting from price distortions

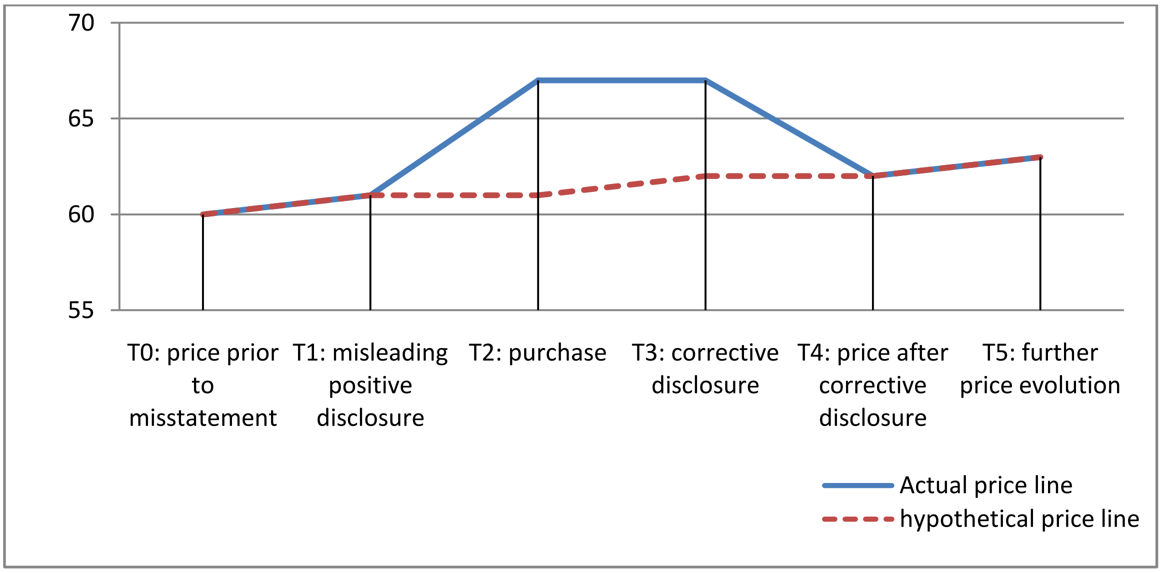
457. Whereas the German courts have not dealt with the matter in detail yet, the calculation of damages according to the market model has proven a major issue in the US courts. Since the market model is fairly undeveloped in Europe at this point – although gaining ground – so far, the US methodology is a prevalent source in this domain and can provide relevant insights to design a method to measure losses for EU Member States as well. Although it was already indicated that US courts struggle with the concept of recoverable loss and damages in the context of securities class actions, the methodology to be used seems fairly well-accepted both by courts and literature.

458. According to the market model, recoverable losses comprise the difference in price between the price paid or received in effectuating a transaction and the price that would have been paid or received absent the misrepresentation causing the distortion. In an influential concurring decision in *Green Petroleum* judge Sneed asserted that damages could be calculated by creating a chart showing the so-called "value-line" which represented the hypothetical price movement of the securities at matter absent the wrong, and the price line, representing the actual price evolution of the security.[1565]

because such Class Members can prove no economic loss that is attributable to any of the Defendants' alleged misrepresentations." In re Estee Lauder Co. Sec. Litig., No. 06-CIV-2505(LAK), 2007 WL 1522620, at *1 (S.D.N.Y. May 21, 2007) ("As it is perfectly plain that plaintiff would have profited if he sold after September 11, 2006, may have profited even if he sold before September 11, 2006, and may well profit in the future if he has not yet sold, this complaint patently fails to plead loss causation for this reason alone."); id. at *1 n.5 ("Plaintiff's contention that an economic loss is sustained simply as a result of the fact that the price of the stock dropped following disclosure is unpersuasive."). See also the references cited in: FISCH, 'Cause for Concern', 848; DUNBAR and SEN, 'Counterfactual keys', 218.

[1564] See also *supra,* para. 438.

[1565] Green v. Occidental Petroleum Corp. 541 F.2d 1335 (9th Cir. 1976) at 1344: "This measure fixes recovery at the difference between the purchase price and the value of the stock at the date of purchase. This difference is proximately caused by the misrepresentations of the defendant. It measures precisely the extent to which the purchaser has been required to invest a greater amount than otherwise would have been necessary. […] Complications result because it becomes necessary to establish, for the period between the date of the misrepresentations and the date of disclosure, data which when arranged on a chart will form, on the one hand, a "price line" and, on the other, a "value line." The price line will reflect, among other things, the effect of the corporate defendant's wrongful conduct. The establishment of these two lines will enable each class member purchaser who has not disposed of his stock prior to disclosure of the misrepresentations to compute his damages by simply subtracting the true value of his stock on the date of his purchase from the price he paid therefore. Fixing the value line for the entire period involved in this case is obviously a more difficult and complex task than would be establishing the price at the date of disclosure of the misrepresentations and the price at all relevant dates prior to disclosure. However, such intimations as have been reflected in the briefs and oral argument suggest that establishing the required value line is practicable."



459. The damages are then calculated as the difference between the value and price line at the moment the purchase or sale took place (T2).[1566] Whereas the price line is relatively easily construed on basis of the actual price evolution as can be viewed in financial and economic databases, the hypothetical value line remains an assessment of a hypothetical situation. Through techniques aimed at measuring the impact of new information on stock prices developed and refined in finance theory, damages experts have introduced a sophisticated approach to construct the hypothetical value line. The following briefly discusses the how these techniques contribute to the calculations of damages in investor litigation.

2. The calculation of damages through event studies in US courts

460. To relate changes in stock prices to the release of new information, financial economists use an event study procedure. An event study is essentially a statistical regression that examines the effect of an event on a dependent variable, in this context the issuer's stock price. As a general proposition, modern finance literature states that market prices of securities reflect expected value based on the available information. Hence, a change in expectations as a result of new information affects the price. The role of event studies is to measure the effect of new information on securities prices.[1567] Event studies are mostly applied to shares, yet may be used with regard to debt instruments and other securities as well.

Over time, event studies have become standard tools to assess price distortions and hence damages in US investor disputes[1568], but regulators both in the US and EU have also used the technique. The UK

[1566] CORNELL and MORGAN, 'Using Finance Theory', 886.

[1567] FAMA, FISCHER, JENSEN and ROLL are considered the pioneering financial economists in this field after the publication of their paper: E. FAMA, M.C. JENSEN, L. FISHER and R.W. ROLL, 'The Adjustment of Stock Prices to New Information', 10 *IER*, 1969, 1.

[1568] "[…] event studies are a common method of establishing loss causation, used routinely in the academic literature to determine whether the release of particular information has a significant effect on a company's stock price.", FindWhat Investor Group v. FindWhat.com 658 F.3d 1282, (11th Cir. 2011) at 1313; See for instance also (amongst a multitude of cases in which event studies have been used with varying success for the plaintiffs' claim): Miller v. Asensio & Co., Inc., 364 F.3d 223 (4th Cir., 2004); In re Executive Telecard, Ltd. Securities Litigation, 979 F.Supp. 1021, (S.D.N.Y., 1997); Hubbard v. BankAtlantic Bancorp, Inc., 688 F.3d 713, (11the Cir., 2012); United States v. Schiff, 602 F.3d 152, 173 n. 29 (3d Cir.2010); In re Imperial Credit Indus., Inc., 252 F. Supp. 2d 1005, 1014 (C.D. Cal., 2003); In re Flag Telecom Holdings, Ltd. Securities Litigation, 574 F.3d 29 (2nd Cir. 2009). See in this regard also: KAUFMAN and WUNDERLICH, 'The troubling dispositive role of

FSA for instance uses the technique to trace unusual trading activity prior to important corporate announcements to discover infringements on the insider trading regulation and ensure 'market cleanliness'.[1569] In the context of investor disputes, events studies are particularly aimed at isolating the price effect of the misrepresentation from other elements, such as (1) market or economy-wide factors, (2) industry-specific elements and (3) unrelated firm-specific elements affecting the securities price.[1570] As such, the price effect of the fraud-related firm-specific elements can be distilled and used to assess the actual recoverable loss. Over time, the literature has established and refined the various steps to perform an event study, which are now more or less uncontested in the relevant literature. The next paragraphs offer a concise overview and offers references for further reading.[1571]

a. Performing an event study: methodology

461. (1) Identification of the relevant event and fixation of the announcement day. The first step involves the determination of the event which impact on the stock price must be measured.[1572] In the context of investor litigation pursuant to misrepresentations, the relevant event is the issuance of new information that causes the investors to change their expectations.[1573] This is generally the date on which the fraud or misrepresentation is revealed or corrected.[1574] In some cases defendants have attempted to fix the date of the misrepresentation – being the date on which the distortion occurs – as the relevant event, and although not impossible,[1575] this is not an evident choice. To the extent it

event studies', 188; ALEX and STOCKER, 'Role of the event study'; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 109, referring to event studies as the "gold standard" accepted by courts and economists to show inflation and dissipation in stock prices.

[1569] D. DUBOW and N. MONTEIRO, 'Measuring Market Cleanliness', 2006, FSA Occasional Papers Series, no. 23, available at http://www.fsa.gov.uk p. 11. See also: R. PATTON and SUSANNE TOFT, 'The use of event studies in disputes and enforcement', *CDR*, 2010, . In the US, the technique is also used to calculate appropriate disgorgement amounts in insider trading cases. See for instance: E. BUCKBERG and F.C. DUNBAR, 'Disgorgement: Punitive Demands and Remedial Offers', 63 *Bus. Law.*, 2008, 361; Minenna M., A Supervisory Perspective on Insider Trading: Estimating the Value of the Information (November 16, 2000). CONSOB, Quaderni di Finanza n. 2000-45. Available at SSRN: http://ssrn.com/abstract=253768, p. 10

[1570] W.H. BEAVER and J.K. MALERNEE, 'Estimating damages in securities fraud cases', 1990, Cornerstone Research Papers: www.cornerstone.com 14p.; LEFLER and KLEIDON, 'Just How Much Damage Did Those Misrepresentations Actually Cause', 290; M.J. KAUFMAN, '26 Securities Litigation Damages § 3:14.50 (The PSLRA's damages formula and experts)', 2012 (Database updated September 2012), Thomson Reuters; D. TABAK and F.C. DUNBAR, 'Materiality and Magnitude: Event Studies in the Courtroom', 1999, NERA Working Paper No. 34, 3; KAUFMAN, '26 Securities Litigation Damages § 3:14.50'.

[1571] See with regard to event studies in general: A. C. MACKINLAY, 'Event Studies in Economics and Finance', 35 *JEL*, 1997, iss. 113; J.C. CAMPBELL, A.W. LO and A. C. MACKINLAY, *The Econometrics of Financial Markets*, Princeton, Princeton University Press, 1997 p. 149 ff. in particular (chapter 4. Event Study Analysis); S.P. KOTHARI and J.B. WARNER, 'Econometrics of event studies', (chapter 1), in B.E. ECKBO (ed.), *Handbook of Corporate Finance: Empirical Corporate Finance*, vol. 1, Amsterdam, Boston, Elsevier, 2007, 4-32; See for (extensive) literature on the use of event studies in securities fraud cases: TABAK and DUNBAR, 'Materiality and Magnitude', 33; BHAGAT and ROMANO, 'Event Studies and the Law--Part I', 141-167; S. BHAGAT and R. ROMANO, 'Event Studies and the Law: Part II - Empirical Studies of Corporate Law', 4 *Am. L. & Econ. Rev.*, 2002, iss. 2, 380-423, BEAVER and MALERNEE, 'Estimating damages', 14; CORNELL and MORGAN, 'Using Finance Theory', 883; M.L. MITCHELL and J.M. NETTER, 'The role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission', 49 *Bus. Law.*, 1994, 545; ALEXANDER, 'Value of Bad News', 1421; A. FERRELL and A. SAHA, 'The loss causation requirement for rule 10b-5 causes-of-action: the implication of Dura Pharmaceuticals v. Broudo', 63 *Bus. Law.*, 2007, 163; P. GRIER, 'Establishing Upper and Lower Limits for Settlement Negotiations in Rule 10b-5 Class Action Litigation', 4 *JLE*, 1994, 1; F. TORCHIO, 'Proper Event Study Analysis in Securities Litigation', 35 *J. Corp. L.*, 2009-2010, 159.

[1572] Idem.

[1573] MITCHELL and NETTER, 'The role of Financial Economics', 558; ALEXANDER, 'Value of Bad News', 1433.

[1574] HAKALA, KAPLAN and THORSEN, 'Rediscovering', 109; ALEXANDER, 'Value of Bad News', 1427; LEFLER and KLEIDON, 'Just How Much Damage Did Those Misrepresentations Actually Cause', 290; ALEX and STOCKER, 'Role of the event study'; FISCH, 'Trouble with Basic', 921-922; CORNELL and MORGAN, 'Using Finance Theory', 889.

[1575] FERRELL and SAHA, 'The loss causation requirement', 167, 186; TABAK and DUNBAR, 'Materiality and Magnitude', 7 ("[…] the events of interest usually include all the alleged disclosures of fraud and/or the dates when fraudulent statements were made"; GRIER, 'Establishing Upper and Lower Limits', 3; B. CORNELL and J.C. RUTTEN, 'Collateral damage and concerns omissions and delayed disclosures, no securities price reaction[1576] will take place in relation to the omitted event – yet coinciding price effects caused by other (unrelated) information may be observed instead – rendering the analysis irrelevant.[1577] Besides inconclusive results in case of omissions or mere delays, caution should also be exercised when drawing conclusions on event studies performed in relation to misstatements. Since event studies only allow for conclusions on the impact of information on the stock price movement if new and unanticipated information reaches the market, prior investor expectations must be taken into account. For example, to the extent the misleading disclosure is in line with the expectations of the investor public and hence does not arouse a change in expectations, no valid observations can be made.[1578] An earnings report or prognoses may for instance contain misleading information, yet not trigger any reaction in terms of price movement because it merely repeats information that has been announced earlier already. Thirdly, in case the misrepresentation is accompanied with other information, it may prove impossible to isolate the effect of the misrepresentation. Assume for instance that an annual report contains misrepresentations as well as new, truthful information. Most likely, the market will respond to the full report, including both the fraud related and fraud-unrelated information it contains. Hence, provided that the misrepresentation represents new information and is isolated from other (possibly simultaneous) announcements, the misrepresentation itself may serve as the relevant event.[1579] [1580] This may for instance be the case when an issuer announces an entirely false statement that has by no means been anticipated in the market, such as the discovery of oil reserves or an unexpected (haphazard) breakthrough in research and development.[1581] If not, corrective disclosures or the moment of market realization, assumed it is

securities litigation', *Utah L. Rev.*, 2009, no. 3, 719 stating that the inflation may be measured *ex ante* if and only if the issuer announces an entirely unexpected and unanticipated false statement which causes the market to react. The statement must be false in its entirety as well. As the authors correctly remark, these situations are rare since misrepresentations often are omissions, may be expected already, or may contain half-truths.

[1576] Unless insiders are trading on the information at least.

[1577] FISCH, 'Trouble with Basic', 921-922; ALEX and STOCKER, 'Role of the event study': "Using event studies to measure price reactions to misrepresentations when made also runs afoul of limitations inherent in the event study methodology."; and "Event studies are not able to measure share price inflation resulting from some of the most common forms of false statements litigated in securities fraud cases, including those that have the effect of maintaining existing investor expectations of company performance."; TORCHIO, 'Proper Event Study Analysis', 159, 164 stating (at 159) that "[m]any of the disclosures in a complaint identify dates in which defendants omitted material information. But, an event study is designed to quantify the effect of disclosed information, not undisclosed information." and that "[s]uch use of an event study is completely improper."

[1578] Idem. See in this regard also the example provided by TABAK, 'Loss Causation', 6: "If the case involves a misstatement, plaintiffs may be able to show that the stock price moved up in response to the false information. Unfortunately, this is not always even possible. For example, suppose a company was expected to earn fifty cents a share but actually only earned forty cents. If the company falsely announces earnings of forty-five cents, the market will be disappointed and the stock price will fall, even though the company has overstated its earnings"; FERRELL and SAHA, 'The loss causation requirement', 186, referring to this approach as 'forward-casting': "The application of the forward-casting approach is straightforward when the false information, which the market believes is true, was unanticipated by the market. In such an event, the stock price reaction (net of market, industry and other confounding effects) associated with the initial dissemination of the misrepresentation would represent the inflation in stock price which potentially harms shareholders by artificially inflating the purchase price."

[1579] FERRELL and SAHA, 'The loss causation requirement', 167; TABAK and DUNBAR, 'Materiality and Magnitude', 7; GRIER, 'Establishing Upper and Lower Limits', 3. See also: DE JONG, *Schade door misleiding*, 250.

[1580] Since the Supreme Court decision in Dura, however, event studies in US securities fraud cases are generally focused on the date of market realization of the truth. The court held that evidence of inflation is not sufficient to pass certification. Although loss and loss causation are to be established only at trial (and not to obtain certification), the fact that an indication of loss and loss causation according to pleading standards must be provided to pass certification, has sometimes caused parties to discuss the existence of recoverable loss and loss causation already in this phase of the procedure. See also: KAUFMAN and WUNDERLICH, 'The troubling dispositive role of event studies', 183; ALEX and STOCKER, 'Role of the event study'.

[1581] The example of the oil reserves discovery is also used in CORNELL and RUTTEN, 'Collateral damage', 719.

known or traceable when the news reached the market, are better suited. The moment when the news (first) reaches the market, is generally referred to as the announcement day or moment.[1582]

462. (2) Fixation of the event window. Following the identification of the event and the announcement date, the event window must be set.[1583] The event window is the period over which the stock price movement is analyzed.[1584] In general, the event window starts shortly before the announcement is made and ends shortly after. It has become customary in this regard to take a three day-event window, including the day before the announcement is made, the announcements day and the day after to analyze stock price movements.[1585] Event windows are preferably as short as possible because the longer the event window, the more noise and unrelated effects may obscure the analysis. In certain circumstances, however, longer event windows are needed to capture all relevant effects. For instance, following the revelation of fraud or deception an overreaction may occur in the market prompted by uncertainty or panic reactions to the news. As these overreactions generally recover over the next days when the market is given time to digest the information and assess the impact and meaning adequately, it may be appropriate to extend the event window or to set various event windows as is common too, in order to capture the correction to overreactions.[1586]

463. Secondly, revelations taking place in the form of one single announcement, causing an instantaneous and full dissipation of the price distortion, only rarely occur. Instead, market realization often gradually arises over a period of time following successive disclosures. Likewise, in case rumors have started to spread doubt on the correctness of previous announcements and information provided by the company, a gradual evolution may take place until the whole truth finally surfaces. In those cases where the news is anticipated, the period of anticipation must be included in an extended event window in order to seize the full effect on the securities price and aggregate the various effects gradually developing.[1587] As mentioned already, however, the use of an elongated event window may reduce its reliability, due to the occurrence of other announcements and events affecting the securities price.[1588] Hence, the length of the window must be balanced against the risk that effects unrelated to the studied event are incorporated.

464. (3) Measurement of the return and controlling for (unrelated) general market and specific industry effects. Once the announcement and event window are established, the next step consists of an examination of the securities returns (i.e. price movements) during the event window.[1589] The actual return consists of the daily price change (in percentages) during the event window.[1590] To

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[1582] BHAGAT and ROMANO, 'Event Studies and the Law--Part I', 141; KAUFMAN and WUNDERLICH, 'The troubling dispositive role of event studies', 191.

[1583] See the references cited in previous footnotes.

[1584] TABAK and DUNBAR, 'Materiality and Magnitude', 7.

[1585] KAUFMAN and WUNDERLICH, 'The troubling dispositive role of event studies', 191.

[1586] FERRELL and SAHA, 'The loss causation requirement', 167-168;

[1587] HAKALA, KAPLAN and THORSEN, 'Rediscovering', 111-112; CORNELL and MORGAN, 'Using Finance Theory', 905-06; FERRELL and SAHA, 'The loss causation requirement', 168.

[1588] D. KRIVIN, R. PATTON, E. ROSE and D. TABAK, 'Determination of the Appropriate Event Window Length in Individual Stock Event Studies', 2003, www.nera.com 3; 141; MITCHELL and NETTER, 'The role of Financial Economics', 558.

[1589] The following is limited to a concise overview of the methodology and technique of event studies as employed in shareholder litigation. For those inclined to the mathematics and further readings into the methodology of event studies and regressions: MACKINLAY, 'Event Studies', 13.

[1590] Although calculated on a daily basis in principle, this can also be done with time ranges of hours, weeks or months. According to finance theory, the calculation of the stock return is expressed as $r = [(P_1 - P_0] + DIV_1]/P_0$ (r being the return calculated, P_1 = the price at the end of the event window, P_0 = the price at the beginning of the period, and DIV_1 = the isolate the price movement due to contemporaneous unrelated factors, such as (1) market or economy-wide factors, (2) industry-specific elements and (3) unrelated firm-specific elements affecting the securities price, the study must filter out these elements. The easiest manner to do this would be to compare the defendant company's securities price movement with that of market and industry indices. However, since the price sensitivity to market tendencies and/or sector or industry specific conditions may vary depending on the company at hand, the degree of price sensitivity must be taken into account.[1591] Price sensitivity to market and industry conditions is often measured by means of the so-called 'market model'.[1592] The market model shows the historical correlation between the defendant-company security price returns and market returns using a linear regression of the security's price on the market and/or industry index.[1593] The regression more particularly calculates the relationship (in terms of return sensitivity) of the defendant company's security to the market.[1594] The regression is generally run on a period prior to the event and indicates whether the company's security price is more sensitive, less sensitive or as sensitive to market or industry conditions as the indices.[1595] The indices used to run the regression should be chosen based on objective criteria and composed of companies with similar relevant features.[1596]

465. (4) Estimating the effects of the analyzed event. Once the relation between the issuing company's security price and the market/industry indices is calculated, the calculated estimations are used to control for contemporaneous industry and market movements of the company's security price during the event window. The predicted return is then compared to the actual return in the event window, implying that the part that cannot be explained by the predicted return – being the abnormal or residual return – suggests a causal relation between the particular event studied and the security

dividend paid during the period of the event window). Or put differently, the return is equal to the change in stock price during the relevant period, plus dividends paid out during the period and relative to the stock price at the beginning of the period. MITCHELL and NETTER, 'The role of Financial Economics', 560.

[1591] See for instance: Miller v. Asensio & Co., Inc., 364 F.3d 223 (4th Cir., 2004) at 234; Hubbard v. BankAtlantic Bancorp, Inc., 688 F.3d 713, (11the Cir., 2012).

[1592] See also: BRUEGGER and DUNBAR, 'Response Coefficients', 5-6; J.T. FINKELSTEIN, 'Rule 10b-5 Damage Computation: Application of Financial Theory to Determine Net Economic Loss', 51 *Fordham L. Rev.*, 1983, iss. 5, 858 ff.; also discussing the market model: DE JONG, *Schade door misleiding*, 243. There is however no consensus regarding the model that should be used to net out market and industry effects. Besides the market model, other models may be employed as well. As a discussion on the various models that may be considered in this regard would lead us too far astray, the topic is not further discussed. See for an overview of alternative models and further references: MACKINLAY, 'Event Studies', 13.

[1593] A regression is used to model the relationship between a dependent variable (in casu the company's security price) and one or more explanatory variables that affect the dependent variable (being the market or industry index). See also: TABAK and DUNBAR, 'Materiality and Magnitude', 9. With regard to regression analysis applied in the context of securities litigation: BEAVER and MALERNEE, 'Estimating damages', 2; MITCHELL and NETTER, 'The role of Financial Economics', 545; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 110.

[1594] *Ibid*. The sensitivity coefficient (ß or beta) thus measures the volatility of the securities at matter vis-à-vis the market or industry index movement. A neutral sensitivity (security price sensitivity equal to the sensitivity of the index) implies that ß=1; a smaller sensitivity: ß < 1; and a price sensitivity exceeding the index sensitivity ß > 1. See also: BRUEGGER and DUNBAR, 'Response Coefficients', 5-6; BEAVER and MALERNEE, 'Estimating damages', 2 ff.; MITCHELL and NETTER, 'The role of Financial Economics', 567; FINKELSTEIN, 'Rule 10b-5 Damage Computation', 861.

[1595] The length of the estimation period (estimation window) concerns another tradeoff. The closer the estimation window is to the event window, the more robust the results since the relationship between the security and the index may vary over time. At the same time, the longer the estimation period, the more data and the more accurate the regression will be since outliers are mitigated and provide a more accurate result. Yet again if too long, outdated data may impact the result and fail to represent the underlying relation during the event window. TABAK and DUNBAR, 'Materiality and Magnitude', 9; BRUEGGER and DUNBAR, 'Response Coefficients', 6 ff.

[1596] *Ibid*. In a case brought by plaintiff-investors against a publicly trading bank holding company, for example, the S&P 500 was used to control for general market conditions, while the NASDAQ Bank Index – an index composed of the stock prices of hundreds of banks and bank holding companies traded on the NASDAQ – was used to filter out industry-specific effects. Hubbard v. BankAtlantic Bancorp, Inc., 688 F.3d 713, (11the Cir., 2012), at 721.

price movement.[1597] Prior to drawing any conclusions from the fact that the predicted return may deviate from the actual return, however, it must also be taken into account that price fluctuations occur daily without any apparent cause or explanation. To rule out such 'random' fluctuation, only statistically significant differences are taken into account.[1598] In *Hubbard v. BankAtlantic Bancorp, Inc*. the expert (for the claimant) found that on the announcement day, the defendant company's stock price fell with 56 percent, whereas the relevant market and industry indices only fell with less than 1 percent.[1599] The expert concluded that the abnormal return, being 55 percent of the decline, could not be attributed to market and industry factors. Hence, the abnormal return could not but follow from company-specific factors, including both fraud-related and fraud-unrelated elements. The method to do so depends on the data available and the type of other events occurring during the event window.[1600]

466. Once the inflationary part of the price is determined, experts apply the inflationary/deflationary part of the price backwards through the period of price distortion and map the distortion at any given day during the period, represented by the price and value line.[1601] US practice has developed essentially three techniques to perform the backcasting over time to draw the value line, being the constant dollar-method (or constant ribbon-method), the constant percentage-method and the index method, a variation derived from the (more simplistic) true value method.[1602] Whereas the

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[1597] TABAK and DUNBAR, 'Materiality and Magnitude', 11; KAUFMAN and WUNDERLICH, 'The troubling dispositive role of event studies', (183) 193; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 110.

[1598] With regard to the statistical test used in this regard, consult: BRUEGGER and DUNBAR, 'Response Coefficients', 9 ff; see also: MITCHELL and NETTER, 'The role of Financial Economics', 562; DE JONG, *Schade door misleiding*, 243-244.

[1599] Hubbard v. BankAtlantic Bancorp, Inc., 688 F.3d 713, (11the Cir., 2012), at 722.

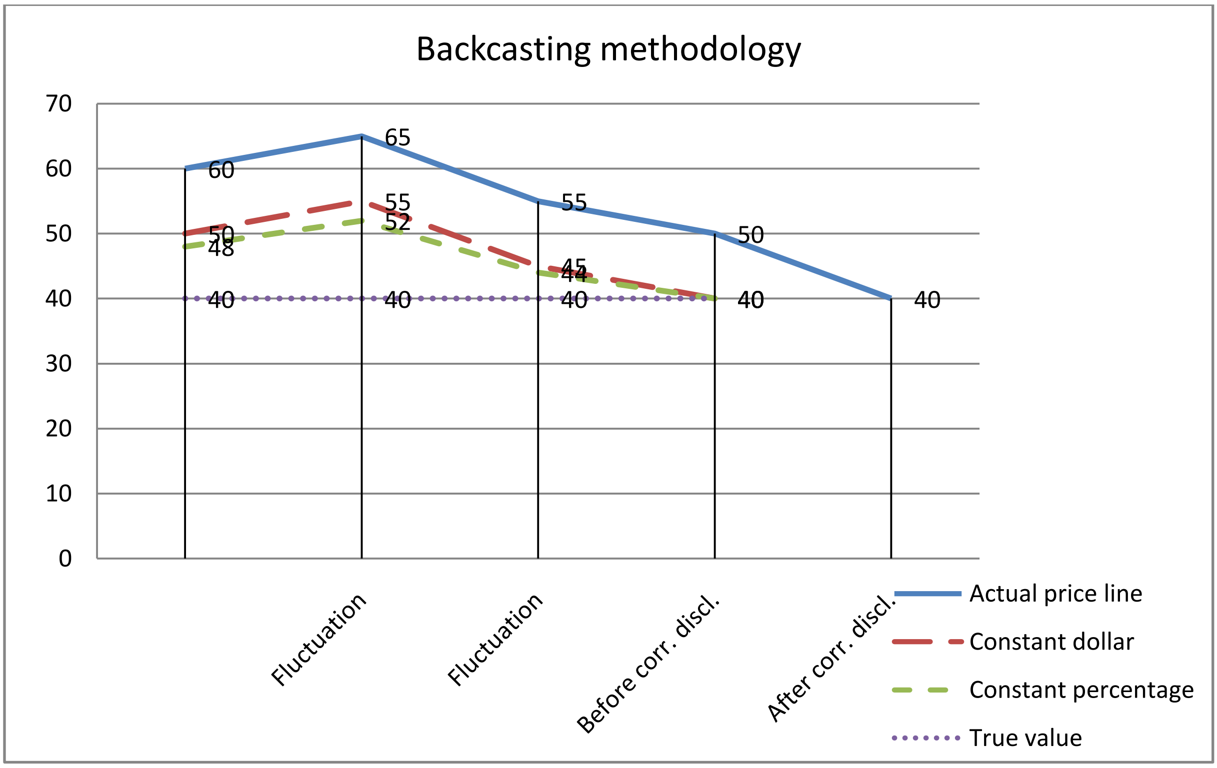
[1600] TABAK and DUNBAR, 'Materiality and Magnitude', 11.

[1601] LEFLER and KLEIDON, 'Just How Much Damage Did Those Misrepresentations Actually Cause', 290; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 109; CORNELL and MORGAN, 'Using Finance Theory', 899; KOSLOW, 'Estimating Aggregate Damages', 822. Note that the literature expresses the measure of the distortion often in percentages, which is usually supported by the contention that – as a matter of economics – stock prices react to new information in percentages. See in this regard for instance: CORNELL and MORGAN, 'Using Finance Theory', 883; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 110; LEFLER and KLEIDON, 'Just How Much Damage Did Those Misrepresentations Actually Cause', 295; FINKELSTEIN, 'Rule 10b-5 Damage Computation', 852. See with regard to the German literature in this regard also: CASPER, 'Significance of the Law of Tort', 102-103. Yet some have argued in favor of expressing the impact of the fraudulent event in dollars. See in this regard for instance: A. FERRELL and A. SAHA, 'Event Study Analysis: Correctly Measuring the Dollar Impact of an Event', April, 2011, Harvard Working Paper, available at: www.law.harvard.edu/programs/olin_center/. However, once again the debate is not neutral since the percentage approach is generally favored by plaintiffs in a scenario where stock prices decline over the class period, which is the most common situation in this kind of litigation. See on this debate and the relevance for the measurement of the damages under both approaches: J.G. HAMMEL and B.J. CASEY, 'Sizing Securities Fraud Damages: 'Constant Percentage' on Way Out?', 241 *NY Law Journal*, 2009, January 21, no. 13; and LEFLER and KLEIDON, 'Just How Much Damage Did Those Misrepresentations Actually Cause', 295. In their aforementioned contribution, LEFLER and KLEIN assert that since Dura, however, the damages are – in absolute terms – limited to the actual decline following market realization, regardless of whether one or the other approach is used, no compensation exceeding that decline can be awarded. Although courts were found reluctant to address the issue for a long time, in the *Williams Securities Litigation* case the (district) court in first instance confirmed that the percentage method is inconsistent with the *Dura* holding. For an extensive analysis of this topic, consult: D. TABAK, 'Inflation and Damages in a Post-Dura World', 2007, available at http://www.nera.com/extImage/PUB_Inflation_and_Damages.pdf. See on this topic also: SPITZ, *La réparation*, 252. See with regard to the decision in *Williams Securities Litigation*: HAMMEL and CASEY, 'Sizing Securities Fraud Damages'.

[1602] TABAK, 'Inflation and Damages', 9-11. See on this topic also: SPITZ, *La réparation*, 252; DE JONG, *Schade door misleiding*, 246 ff. The index method is essentially a refinement of the so-called true value method. The true value method simply assumes that the established 'correct price' following market realization has been constant throughout the period during which the distortion lasted. The index method is more refined in this regard since it ties that value to an index and hence backcasts the inflationary part dependent on the index movements. The advantage of this method evidently lies with the fact that endogenous factors are taken into account. The drawback however is that the index and stock are likely to be affected – at least to some extent – differently by these factors. TABAK and OKONGWU, 'Inflation Methodologies', 10 and ftn. 12.

constant dollar and the constant percentages-method are generally applied in the context of events studies, the index method is not.[1603]

467. The constant percentage-method for instance assumes that the percentage of inflation has been constant throughout the period of distortion and hence applies that percentage over the price during the period of price distortion. Assume for instance stock dropping from 50 to 35 following a corrective announcement. Applying a regression study reveals that 20 percent of the drop cannot be attributed to general market and specific industry effects, indicating that the misreporting caused a return drop of 20 percent (50 to 40). According to the constant percentage-method the drop of 20 percent implies that the misrepresentation caused a continuous distortion of the price of 20 percent, implying that the value line must be drawn at 20 percent below the actual price during the period in which the distortion occurred. The constant dollar-method on the other hand assumes that the price drop attributed to market realization of the misrepresentation is constant throughout the period of distortion (being a drop of 10). Hence, according to the constant dollar-method, the value line is drawn at the actual price minus a dollar value of 10. The index method then again assumes that the price during the distortion period has fluctuated in a similar fashion – i.e. in the same proportion – as a representative index. This means that if the selected index declined with 20 percent during the period of distortion, it is assumed that the hypothetical stock price would have suffered an equal blow. To reach a level of 40 after correction, the stock must have traded for 50 in order to amount to 40 after a 20 percent drop. It is hence assumed that throughout the distortion period, the 'correct price' of the security would have been around 40, implying that anything above that amount is inflationary. Since this latter methodology assumes that nothing but the misrepresentation affected the price during the distortion period, this is a highly doubtful approach in case the distortion has lasted for a considerable period.[1604]



[1603] For a comparison of the two techniques, consult the following literature: CORNELL and MORGAN, 'Using Finance Theory', 897-911; TABAK and OKONGWU, 'Inflation Methodologies', 7-11.

[1604] TABAK and OKONGWU, 'Inflation Methodologies', 10.

468. The most common used method in US courts has been the constant percentage method. Proponents of this approach usually support their preference for this method holding that – as a matter of economics – stock prices react to new information in percentages.[1605] Yet some have argued in favor of expressing the impact of the misleading event in dollars in certain circumstances.[1606] Without elaborating on the economic underpinnings of each approach, it can however be concluded that authoritative literature pointed out that the method chosen to draw the value line in fact depends on the circumstances of the case.[1607] As a final remark, it should also be noted that once again the debate on the methodology is not entirely neutral since the percentage approach is generally favored by plaintiffs in a scenario where stock prices decline over the class period, which is the most common situation in this kind of litigation. Finance theory however can assist and serve as an objective and verifiable source to support the chosen methodology in a given case. Once the value line has been drawn according to the most appropriated approach, damages can be awarded to individual plaintiffs who have purchased on various days in accordance with the degree of distortion on that very day.[1608] [1609]

b. The need for qualitative and reliable expert testimony

469. The preceding paragraphs clearly illustrate that event studies may be a very useful and objective method to measure price distortions. It goes without saying however that this implies that the event studies used in court meet certain quality standards and have been performed according to acknowledged and reliable methods. In a reaction to expert witnesses employing what has been called 'junk science' by some, the US Supreme Court has determined legal standards for the admissibility of expert testimony, the so-called Daubert standard.[1610] According to the Daubert standard courts should only admit evidence that meets certain criteria regarding its relevance and reliability. These criteria particularly state that the evidence offered (1) must be supported by theory or technique that can be tested and (2) should have been subject to peer review and publication. Furthermore, (3) the potential rate of error and standards controlling the technique's operations must be considered and the (4) general acceptance of the theory or technique in the scientific community. With these criteria, the court aims to ensure that the evidence presented measures up to a certain minimum level of scientific validity.[1611] The court is nonetheless well aware that this essentially requires that a balance must be

[1605] See in this regard for instance: CORNELL and MORGAN, 'Using Finance Theory', 883; HAKALA, KAPLAN and THORSEN, 'Rediscovering', 110; LEFLER and KLEIDON, 'Just How Much Damage Did Those Misrepresentations Actually Cause', 295; FINKELSTEIN, 'Rule 10b-5 Damage Computation', 852. See with regard to the German literature in this regard also: CASPER, 'Significance of the Law of Tort', 102-103.

[1606] See in this regard for instance: FERRELL and SAHA, 'Event Study Analysis', 1.

[1607] TABAK and OKONGWU for instance distinguish various scenarios and develop distinct criteria to determine the most appropriate method in a given case; consult: TABAK and OKONGWU, 'Inflation Methodologies', 20 p.

[1608] Instead of mapping per day, it can also be done per week, month or hour if needed.

[1609] Note however with regard to the US that following the PSLRA damages are capped at the difference between the purchase or sale price paid or received and the mean trading price of the security during a 90-day period beginning on the date of the corrective disclosure. To the extent the latter standard would be exceeded, damages will be capped accordingly. S.21D (e) (1) SEA 1934 (15 USC § 78u 4(e)(1) (2006)). See also *infra*: para. 484 with regard to the capped damages.

[1610] *Daubert v. Merrill Dow Pharmaceuticals*, 509 U.S. 579 (1993). The Daubert standard applies to expert witness testimony in general and in all fields of law. The Daubert standard was confirmed and refined in subsequent decisions, such as: In Kumho Tire Co, Ltd v. Carmichael, 525 U.S. 137 (1999), which held that the standard should be applied with flexibility;: *In re Williams Sec. Litig.* – WCG Subclass, 558 F.3d 1130 (10th Cir. 2009); see also the overview of case presented in: D. BERNSTEIN, The Daubert Counterrevolution, 2013, Notre Dame Law Review, Forthcoming; George Mason Law & Economics Research Paper 03-13. Available at SSRN: http://ssrn.com/abstract=2224129, 59p. Note that the Daubert standard have been codified in Federal Rule of Evidence 702. See also: TABAK and DUNBAR, 'Materiality and Magnitude', 1.

[1611] For an application in the context of securities fraud litigation, see for instance the decision passed down by the Oklahoma district court: *In re Williams Securities Litigation,* 496 F.Supp.2d 1195 (N.D. Okla. 2007); affirmed in appeal: *In re Williams Sec. Litig.* – WCG Subclass, 558 F.3d 1130 (10th Cir. 2009).

struck since scientific theories and techniques are subject to perpetual revision, whereas law must resolve disputes quickly and finally.[1612]

470. Whereas the above does not serve to instruct other jurisdictions to duplicate the US solution, the concern with regard to the quality of the evidence presented is a proper one worth consideration. While other means and standards can be thought of, suited to the specific jurisdiction at matter, the purpose is a common one well worth the attention.[1613] Another suggestion in this regard is for instance the nomination of court-appointed experts facilitating the court to come to a decision.

c. Complications and limitations in performing event studies

471. Confounding information, leakage and anticipation. – It has become well understood by both economists and courts in the US that event studies are a very helpful instrument in assessing the impact of misrepresentations, provided that the event is well-defined, the announcement date is well known, the market has not anticipated the news and finally, that the effect of the event can be isolated from other contemporaneous unrelated events.[1614] Oftentimes however the case is not as straightforward as one would like and complications may arise, affecting the reliability of the event study. BRUEGGER and DUNBAR for example point out that the reliability of event studies may be threatened in case unrelated information is disclosed simultaneously with the relevant announcements, turning the isolation of the impact of the misrepresentation(s) into an arduous – yet not impossible – task in some instances.[1615] Other difficulties to be taken into account concern leakage and market anticipation. In these cases, the moments on which the news has been leaked into the market may be added for analysis, either by extending the event window or just adding the particular days in order to add up the outcomes to the final result.[1616]

472. Buildup of price distortion over extended periods. – Secondly, a buildup of inflation per share over an extended period of time due to a sequence of misrepresentations may also prove troubling, since the degree of distortion changes most likely increases after every new disclosure.[1617]

[1612] *Daubert v. Merrill Dow Pharmaceuticals*, 509 U.S. 579 (1993), at 597. As the court puts it, "That, nevertheless, is the balance that is struck by Rules of Evidence designed not for the exhaustive search for cosmic understanding but for the particularized resolution of legal disputes."

[1613] Note for instance that in the UK evidence can be excluded if considered too biased. A. ZUCKERMAN, *Zuckerman on civil procedure*, London, Sweet and Maxwell, 2006, para. 20.16; P. LOUGHLIN and S. FGERLIS, *Civil procedure*, London, Cavendish, 2004, 457. In Belgium, statutory rules provide a framework for the assignment of experts (art. 962-990 Ger. W.). According to these provisions experts can be assigned by the court, or they can be asked to testify by one of the parties involved. The experts appointed by court can be dismissed ("*wraken*") by the court in case their impartiality is not ensured (art. 966 Ger. W. in conjunction with 828 Ger.W.), whereas the reliability and impartiality of the experts acting for one of the parties involved is to be objectively assessed and evaluated by the court. The court uses its discretionary powers to assess expert testimonies and is not bound by these testimonies. See in this regard: T. LYSENS and L. NAUDTS, *Deskundigenonderzoek in burgerlijke zaken*, Mechelen, Kluwer, 2010, 78-90; J. LAENENS, K. BROECKX and D. SCHEERS, *Handboek gerechtelijk recht*, Antwerpen, Intersentia, 2012, 597 ff.; M. CASTERMANS, *Gerechtelijk Privaatrecht*, Gent, Story, 2009, 541 ff.

[1614] BRUEGGER and DUNBAR, 'Response Coefficients', 16; FISCH, 'Trouble with Basic', 921; and: FERRELL and SAHA, 'The loss causation requirement', 170; also COX, HILLMAN and LANGEVOORT (eds.), *Securities Regulation*, 729.

[1615] BRUEGGER and DUNBAR, 'Response Coefficients', 16. The authors point out however that in some instances certain techniques (the authors name content analysis for example) may remedy the problem. See also the references cited in the previous footnote in this regard, including FERRELL and SAHA, 'The loss causation requirement', 170, showing that an intra-day data analysis may solve the problem in some cases. See in this regard also COX, HILLMAN and LANGEVOORT (eds.), *Securities Regulation*, 729.

[1616] BEAVER and MALERNEE, 'Estimating damages', 5; FISCH, 'Trouble with Basic', 919; DE JONG, *Schade door misleiding*, 240-241.

[1617] BRUEGGER and DUNBAR, 'Response Coefficients', 16.

Assume for instance a minor misrepresentation in the financial statements regarding the earnings, followed by several reiterations of the lie in subsequent reports and other exaggerations regarding the earnings and revenues, until over the years, the truth is revealed and it appears that the earnings and forecast have been increasingly optimistically misrepresented. Those who purchased their shares after the first, but before any subsequent misrepresentation are likely to suffer a distortion less grave than those who purchased after any of the later misrepresentations that aggravated the matter and, by assumption, had a larger impact. The calculation of the first misrepresentation only appears troubled since the corrective announcement discloses the series of misrepresentations over the years.[1618]

473. Notwithstanding these limitations however, it is clear that event studies are a useful tool that may provide guidelines and instructions as to the higher and lower limits of the damages for courts and plaintiffs in an objective and verifiable manner. Even if no exact result can be achieved, event studies provide us with a best estimate and make a valuable improvement to other more arbitrary and subjective calculations of damages, provided that these event studies have been carried out according to acknowledged and objective methods. It goes without saying that the scope of the damages remains a matter for the courts to decide in a discretionary matter, yet whenever appropriate, objective and verifiable tools should be considered as a means to support and facilitate the assessment of damages.

3. The calculation of German mispricing losses ('*Kursdifferenzschaden*')

474. The availability of verifiable techniques developed in finance has also been noticed in the German literature and courts with regard to calculation of the mispricing damages. In its EM.TV-decision, the German Supreme Court expressly refers to the academic literature discussing the technique of event studies when considering the scope of the damages to which an investor-claimant is entitled when claiming mispricing damages.[1619]

475. Although the German Supreme Court thus appears willing to consider the methods of modern finance theory, alternatives have been proposed in the literature as well.[1620] One approach concerns a simplification of the US model and suggests measuring the corrective drop in percentage and applying it to the initial transaction price.[1621] Another approach advanced in the literature and referred to as a

[1618] For a detailed example, see for instance: *Ibid*., 16.

[1619] "[...] so besteht doch in der herrschenden Meinung der Literatur Übereinstimmung, daß sich trotz aller Schwierigkeiten der hypothetische Transaktionspreis mit den Methoden der modernen Finanzwissenschaft durchaus mit der erforderlichen Sicherheit errechnen läßt [...]", BGH, 9 May 2005, II ZR 287/02, *ZIP* 2005, 1270 (EM.TV); and: "Als geeignete Hilfsgröße zur Ermittlung des hypothetischen Preises kann auf die Kursveränderung unmittelbar nach Bekanntwerden der wahren Sachlage zurückgegriffen und sodann "vermittels rückwärtiger Induktion" auf den wahren Wert des Papiers am Tage des Geschäftsabschlusses näherungsweise geschlossen werden […]". Note that the BGH reverts to these considerations regarding the calculation of *Kursdifferenzschaden* in its later IKB decision (BGH, 13 December 2011, XI ZR 51/10, (IKB), available at: http://juris.bundesgerichtshof.de; see also: *BB* 2012, 530 with annotation by MÜLLER-MICHAELS, 'BGH verschärft Haftung', 537). The BGH particularly refers to: H. FLEISCHER, 'Der Inhalt des Schadensersatzanspruchs wegen unwahrer oder unterlassener unverzüglicher Adhoc-Mitteilungen', *BB* 2002, heft 37, 1869; see in this regard also: CASPER, 'Significance of the Law of Tort', 102-103.

[1620] FLEISCHER, 'Inhalt des Schadensersatzanspruchs', 1869; see in this regard also: CASPER, 'Significance of the Law of Tort', 102-103; SCHÄFER, WEBER and WOLF, 'Berechnung und Pauschalierung des Kursdifferenzschadens', 200; WAGNER, 'Schadensberechnung', 495.

[1621] FLEISCHER, 'Inhalt des Schadensersatzanspruchs', 1869. To illustrate this approach, an example was provided by RICHTER: suppose an investor purchases securities at a price of 100 a piece. Over time, the price declines to 60 as a result of market tendencies. Following an unexpected announcement by the issuer conveying that material information has been misrepresented, the price immediately drops to 48, which means a decline with 12 or 20 percent. Because the inflation has been measured to be 20 percent of the price, the investor-plaintiff who purchased at 100 after the misrepresentations had been made, he is entitled to recovery up to 20 percent of the initial purchase price or 20. See: RICHTER, *Schadenszurechnung*, 99.

‘lump sum-approach’ (‘*Pauschalierung’* as the authors call it) proposes to measure the damages as the difference between the average security price over the last ten trading days, ending at the second day before the market realizes the misrepresentation, and the average price in the ten days following the revelation starting from the second day after.[1622] The investor-plaintiff is entitled to the price difference resulting from this measurement in absolute numbers as this approach – contrary to the aforementioned method – does not measure the difference in percentages.[1623]

476. Compared to event studies, both these methods clearly involve a more rudimentary approach to the calculation of damages. According to SCHÄFER, WEBER and WOLF, the simplicity is the main advantage of their solution as it dispenses with the need for experts and hence the costs associated with those experts.[1624] The authors however acknowledge that experts cannot entirely be excluded since they may still be required to determine the moment in which the information has been leaked into the market when this has not happened through a corrective disclosure or another clearly distinguishable event.[1625] However, by limiting their task to determining the date on which the relevant information reached the market (by means of specialized databases), costs are still kept to the bare minimum, and below the costs that would be made if the experts were asked to determine the concrete damages, for instance through conducting event studies.[1626]

477. Summarized, the advantages of a lump sum-approach as advanced in the aforementioned literature concern its simplicity and low cost character. On the downside however the simplicity and low costs associated with approach are paid for in terms of a less sophisticated and less accurate outcome, even though a more objective and reliable method is at the courts’ disposal. Event studies are commonly employed in finance already, used by supervisors and unlikely to cause costs to soar beyond reasonable levels. To the extent the loss can measured in an accurate and precise manner with well-established and reliable tools, it is not clear why they should not be used. Moreover, the proponents realize that the suggested lump sum-approach may be an instrument too crude to use in certain individual cases and meet this criticism by proposing to correct the outcome in case fraud-unrelated factors have affected the outcome provided that counter-evidence is presented. It seems evident that in case defendants find that the loss actually caused by their alleged misrepresentations is smaller than the outcome of the proposed lump sum assessment, they will support their arguments with counterevidence such as expert opinions, which may use and event studies to support their analysis. In short, when given the chance to present counter evidence – and it only seems fair that this chance is offered – it seems apparent that event studies will be used anyway, reducing the lump sum-approach no more than an empty shell.

478. Secondly, it should be noted that the lump sum-approach measures loss in a manner similar to event studies to a certain extent, since it uses the corrective price movement in reaction to news reaching the market as its focal point. As such, it suffers the very same difficulties event studies

[1622] SCHÄFER, WEBER and WOLF, 'Berechnung und Pauschalierung des Kursdifferenzschadens', 200. *Contra* (rejecting a lump sum-approach to calculate the damages in this context): DUVE and BASAK, 'Welche Zukunft hat die Organaußenhaftung für Kapitalmarktinformationen?’, 1648. For a discussion of both the benefits and drawbacks of a lump sum-approach: BARTH, *Schadensberechnung*, 291 ff.

[1623] See for a discussion of this approach also RICHTER, *Schadenszurechnung*, 99-100. The latter considers the abandonment of the price spread measured in absolute numbers instead of in percentages the main difference with the other approaches suggested in the literature.

[1624] Similar: BARTH, *Schadensberechnung*, 291.

[1625] RICHTER, *Schadenszurechnung*, 99-100.

[1626] *Ibid.*, 99-100.

encounter in case confounding information is simultaneously released or in case the information has not been disclosed in a single moment but gradually built up over time. The same applies in case the truth has been leaked or is revealed in sequential announcements, spread in time and with exogenous factors affecting the price during this time span. Accordingly, the lump sum-approach does not appear better suited in the aforementioned examples of complicated situations, and yet even less so in straightforward situations as it is bound to lead to a less accurate outcome than a properly conducted event study. A final remark with regard to the lump sum-approach concerns the incentives it creates for potential dishonest defendants. Knowing that a ten day period will be used to assess the damages, the latter may be tempted to disclose other information in the relevant period following market realization in order to limit the loss.

479. For the sake of completeness, it should be noted that the draft legislation (which never got enacted) amending §§37b, c WpHG (‘*Kapitalmarktinformationshaftungsgesetz'*, or the Capital Market Information Liability Act or "KapInHaG") also introduced a measure of damages to be applied in the context of liability for erroneous ad hoc disclosures. Similar to the proposal discussed in the preceding paragraphs, the draft also advanced a lump sum approach implying that the damages should be equal to the difference between the purchase price and the weighted average stock market price during thirty days following the announcement of the deception.[1627] Criticism on this proposal concerns its rather crude approach to the assessment of damages since losses due to exogenous factors are included, rendering this approach to damages essentially identical to the one employed under the investor reliance model, and as such unsuitable in the light of the conceptual different character of *Kursdifferenzschaden*.[1628]

4. Limits to recoverable loss under the market based-approach

a. Side effects of misrepresentations: overreactions, over-disclosure and collateral damage.

480. Over- and under-disclosure. – Over-disclosure is the term coined for the situation in which the eventual corrective disclosures differ from the initial misrepresentation and cause a sharper price reaction than would have been the case had the statement been announced immediately.[1629] For instance, assume a company holding back that talks concerning a potential merger were started and have reached an advanced stage. When all essential elements of the transactions have been discussed and agreed on, the market discovers the situation, although the news now concerns the fact that a merger will take place instead of an announcement of mere negotiations.[1630] The market is likely to react stronger to the news that a merger is actually at hand, rather than the mere fact that the possibility exists. A similar situation occurs when an issuer wrongfully conceals the emergence of certain risks

[1627] TEICHMANN, 'Haftung für fehlerhafte Informationen am Kapitalmarkt', 959; CASPER, 'Significance of the Law of Tort', 102-103; SCHÄFER, WEBER and WOLF, 'Berechnung und Pauschalierung des Kursdifferenzschadens', 199; DUVE and BASAK, 'Welche Zukunft hat die Organaußenhaftung für Kapitalmarktinformationen?', 1645.

[1628] VEIL, 'Die Haftung des Emittenten für fehlerhafte Information des Kapitalmarkts nach dem geplanten KapInHaG', 91; CASPER, 'Significance of the Law of Tort', 102-103 (considering this approach "all too simplistic"); see also: DUVE and BASAK, 'Welche Zukunft hat die Organaußenhaftung für Kapitalmarktinformationen?', 1648.

[1629] See with regard to over- and under-disclosure: CORNELL and MORGAN, 'Using Finance Theory', 889; CORNELL and RUTTEN, 'Collateral damage', 719.

[1630] For similar examples: CORNELL and RUTTEN, 'Collateral damage', 720; CORNELL and MORGAN, 'Using Finance Theory', 889 ff.

with potential negative implications for the company's performance and only announces the existence of these risks once they are about to materialize or have already materialized. The fact that the news no longer concerns the possibility of a certain event, but instead the occurrence of the event with (probability close to) certainty is bound to provoke a stronger market reaction. As CORNELL and MORGAN indicate, the only solution to this problem is to estimate the 'equivalent disclosure price', which is the price at which the security would have traded if the news had been announced timely and accurately.[1631] Admittedly, the determination of the equivalent disclosure price is a highly factual and uncertain undertaking, so that a best estimate based on the circumstances of the case is probably the closest one can get. Or as CORNELL and MORGAN put it, "no formulaic approach provided by finance theory, or any other theory, can replace a detailed analysis of the facts".[1632]

481. Overreaction. – The phenomenon of overreaction occurs when a sharp price drop or increase is observed directly after the news reaches the market, yet dampens to some extent in the following days. Explanations for this phenomenon have been sought in (panic) reactions from the investor public, and particularly the segment of uniformed investors that is generally unable to assess the implications of the news and start mimicking market trend by quickly buying or selling off securities following the news. This phenomenon has also been referred to as 'lemming-like' investor behavior or the bandwagon or herding effect in the literature.[1633] Other explanations contributing to a crash mentioned by the authors concern the role of hedging strategies involving automatic sales following price declines, thereby causing a downward spiral since the automatic sale orders trigger other automatic orders and so on.[1634]

482. Collateral damage. – The term 'collateral damage' is employed in the literature to describe price movements following market disclosures caused by factors related to the revelation, yet not directly caused by the information itself.[1635] The above already discussed the phenomenon of stock price crash or crash components in price drops resulting from (panic) reactions by the investor public caused by the inability to assess the implications of the news. Besides overreactions however, price drops following market realizations of misrepresentation, yet not directly related to the original inflation or deflation of the price, may also be caused by heightened uncertainty about the future of the company[1636], concern or expectations that shareholder litigation is likely to be initiated following the announcement, a general upswing in terms of awareness of investment risk, or a blow in the investor

[1631] CORNELL and MORGAN, 'Using Finance Theory', 894-897; and CORNELL and RUTTEN, 'Collateral damage', 720.

[1632] CORNELL and MORGAN, 'Using Finance Theory', 896. See also: CORNELL and RUTTEN, 'Collateral damage', 720, addressing the matter as a "vexing" problem.

[1633] With regard to (irrational) investor behavior, see for instance: D.A. HIRSHLEIFER and S.H. TEOH, 'Herd Behaviour and Cascading in Capital Markets: a Review and Synthesis', 9 *European Financial Management*, 2003, No. 1, 25; SHILLER, *Irrational exuberance*, 157; M. BURGHARDT, *Retail Investor Sentiment and Behavior: An Empirical Analysis*, Wiesbaden, Springer, 2011, 94 ff. See on the causes of crashes also: LEV and DE VILLIERS, 'Stock Price Crashes', 13-18; and: CORNELL and RUTTEN, 'Market efficiency', 463.

[1634] LEV and DE VILLIERS, 'Stock Price Crashes', 15.

[1635] With regard to collateral damage, consult: FERRELL and SAHA, 'The loss causation requirement', 179. These authors seem to have used the term for the first time, after which it was adopted in other publications: CORNELL and RUTTEN, 'Collateral damage', 717; DUNBAR and SEN, 'Counterfactual keys', 231. Rather than naming it collateral damages, BLACK prefers the term reputational damages instead: B. BLACK, 'Reputational Damages in Securities Litigation', 35 *J. Corp. L.*, 2009, 174.

[1636] FERRELL and SAHA for instance illustrate this with an example of an announcement or account statement fraud, which may be considered only the tip of the iceberg by investors. Since that market believes that more – currently undisclosed – difficulties, problems and possibly even other dishonesties may follow suit, more investor will lose their appetite for the issuer's securities and sell off their participation, causing the price to take a deeper dive. FERRELL and SAHA, 'The loss causation requirement', 176.

public's confidence in the company or its management capacities and integrity, its internal control system etc.[1637]

Definitions of the term 'collateral damage' vary to some extent in the literature. The authors originating the term defined collateral damage as that the (part of the) price drop following market realization that cannot be attributed to the original misrepresentation and hence, has not contributed to the initial inflation.[1638] SEN and DUNBAR on the other hand define collateral damage as the drop in the stock price "caused not by the facts revealed in a disclosure *per se*, but rather by ancillary effects arising from the disclosure".[1639] CORNELL and RUTTEN yet propose to define collateral damages as "the valuation impact of a corrective disclosure that does not correspond to the original inflation".[1640] BLACK finally proposed to substitute the term "collateral damage" by "reputational damage", meaning "those damages flowing from a material misstatement in excess of the stock price decline that would have occurred had there been timely disclosure of the accurate negative information and resulting from the market's reassessment of the integrity of management or its internal controls".[1641] [1642]

Overall and similar to overreactions[1643], these definitions allow for the conclusion that collateral damage covers price movement not to be attributed to the misrepresentation itself, and as such unrelated to the original inflation or deflation of the price. Hence, collateral damage is excluded from the concept of recoverable loss as developed and employed in finance theory. From a legal perspective, the question thus arises to what extent the loss caused by these side effects should be recoverable, and hence, whether the concept of recoverable losses under the price causation model as developed in this chapter should be adjusted to include these damages.

483. Recoverability of collateral damage and overreactions. – Considering whether these losses should be recoverable, it is firstly observed that the notion of 'collateral damage', defined as loss flowing from a material misstatement in excess of the stock price distortion that would have been avoided had there been timely and accurate disclosure, includes a wide range of possible losses.[1644] Although it is not implausible that these effects occur when the misrepresentation is revealed, the impact and even the existence of changing perceptions of the reputation of the company or management, its integrity and competence are hard to measure.[1645] Hence, it may well be that the inclusion of this kind of damages increases uncertainty with regard to the scope of damages for the parties involved, not in the least listed companies found to have contravened the rules.

[1637] See: CORNELL and RUTTEN, 'Collateral damage', 722 ff.; FERRELL and SAHA, 'The loss causation requirement', 179 ff.; DUNBAR and SEN, 'Counterfactual keys', 231 ff.; BLACK, 'Reputational Damages', 174 ff. See on the causes of crashes also: LEV and DE VILLIERS, 'Stock Price Crashes', 13-18.

[1638] FERRELL and SAHA, 'The loss causation requirement', 181.

[1639] DUNBAR and SEN, 'Counterfactual keys', 231.

[1640] CORNELL and RUTTEN, 'Collateral damage', 721. The authors find the definition and examples provided by SAHA and FERRELL "confusing" as used and illustrated in the examples presented in the contribution.

[1641] BLACK, 'Reputational Damages', 174-175.

[1642] Although the definitions seem to consider collateral damage mostly in the context of inflated securities prices, collateral damage may potentially also occur in situations of deflation, depressing the increase following market realization.

[1643] Although collateral damages may therefore include overreactions, the term also covers a wider spectrum of factors that do not necessarily dissolve in the days following market realization.

[1644] Collateral damage seems a catch-all for those effects associated with, albeit not per se caused by, the revelation of deception and material misstatements. See in this regard also: DUNBAR and SEN, 'Counterfactual keys', 240. The authors also present an overview of different types of collateral damage: *Ibid.*, 237-240, stressing the need for factual analysis.

[1645] Criticizing the concept of collateral damage for its 'nebulous' nature, CORNELL and RUTTEN warn against the recoverability of these losses. CORNELL and RUTTEN, 'Collateral damage', 727; CORNELL and RUTTEN, 'Market efficiency', 462.

Secondly, given the variety in what may constitute collateral damage, it seems incorrect to generalize between the various forms in which collateral damage may manifest itself and ignore relevant differences that may exist. For example, not all price drops following corrective announcement *cause* the need for reassessment, as much as they may just *trigger* a (re)assessment. For instance, whereas a price drop due to fear for shareholder litigation or public authority prosecution following the revelation of market manipulation is more or less directly related to the occurrence of misrepresentations, this is not inexorably the case when it concerns doubts with regard to management capacities or internal control systems.[1646] For example, it is possible that internal control was insufficient for a long time already and that the revelation of the manipulation only triggered its reassessment.[1647] Or a certain degree of laxity may not have been known until now, yet it remains a separate issue, at most indirectly related to the fact that misrepresentations have occurred. As such, the fact that internal control is rather poor may be one of the various reasons for (part of) the price drop, yet it is not directly related with the misrepresentation at hand.[1648] Along the same lines, a sharp price drop following disclosures revealing the misrepresentation may bring about a heightened awareness of investor risk in general, the fraud or misstatement in the given case as such has not increased any investment risk for that matter. Summarized, the causal connection between the misrepresentation and losses – other than inflation or deflation directly caused by the misstatement – must be assessed on a case by case basis. It is noted in this regard that losses resulting from bubbles, crashes and other overreactions outside the context of fraudulent misstatements are – as a matter of principle – deemed irrecoverable. The mere fact that they occur simultaneously with market realization of misrepresentations, regardless of whether the occurrence of misstatements triggered these market movements, should not change the fact that these losses are generally considered a risk inherent to investments.

Thirdly, allowing investor-plaintiffs to recover collateral damage and losses due to sales at panic moments when prices reached a negative peak has important consequences with regard to the circle of licit plaintiffs allowed to file for damages. More particularly, collateral damage and losses due to sales at panic moments are exclusively suffered by those trading within the period of price distortion, but include each and every investor holding the securities at matter at the moment when these price effects materialize.[1649] The implications of this kind of liability are obviously highly unpredictable in any given case because of its dependence on whether or not overreactions or collateral damage occurs and

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[1646] For a detailed example involving a reassessment of the company's internal controls, see: FERRELL and SAHA, 'The loss causation requirement', 181-183.

[1647] See with regard to the distinction between triggers and causes in this context also the analysis made by CORNELL with regard to a stock price crash observed after a press release by Intel. Upon analyzing the market reaction – causing the stock price to lose 30 percent of its value or 120 billion dollar – CORNELL found that the announcement could only count for a minor part of the drop. The major cause seems to lay with a reassessment of analysts of the company's performance strategy in the long run, which has been triggered by the announcement. As such, the announcement served as a catalyst to revise prior assessments, which turned out to be outdated and had to be corrected significantly. To some extent, the announcement hence triggered the drop, yet it is not the cause of it, according to the author and supported by his analysis. See: B. CORNELL, 'Is the response of analysts to information consistent with fundamental valuation? The case of Intel', 30 *Financial Management*, 2001, No. 1, 113-136.

[1648] See in this regard also the US literature, in which a strand of argumentation denying recovery for collateral damage is based on the lack of causation between the alleged wrong and the claimed loss. It is more particularly argued losses other than the original price distortion, be it inflation or deflation, are too loosely connected with the alleged misstatement and hence fail to satisfy the proximate or direct cause requirement. See in this regard: FERRELL and SAHA, 'The loss causation requirement', 183 (with regard to the market's reassessment of internal control and management capacities/integrity), 185 (with regard to disruptive shareholder litigation following the corrective announcement); CORNELL and RUTTEN, 'Collateral damage', 744.

[1649] CORNELL and RUTTEN, 'Collateral damage', 746.

in what proportions. In case overreactions and/or collateral damage occurs and takes a considerable proportion, the financial impact of such litigation is likely to be disastrous for an issuer-defendant.[1650] Some have therefore considered the inclusion of collateral damage as recoverable loss would lead to "utterly open-ended and unpredictable" outcomes, contrary to what the (US) legislator aimed for.[1651]

484. Exclusion of temporary price reactions. – For these reasons, courts may feel inclined to employ corrective measures aimed at isolating those losses exceeding the initial price distortion.[1652] It should be stressed however that except for temporary price effects, it will prove very difficult to distinguish between price reactions directly caused by the misreporting itself and collateral losses.[1653] Temporary price effects due to overreactions on the other hand may be excluded by using a bounce back-rule, as it has been termed in the US. A bounce back-rule implies that the loss is measured through the price drop following market realization, although that the lowest point in the price drop is not measured at the moment when the news reaches the market, nor shortly after, but as an average over a prolonged period of time in order to allow the recovery to seep in. US law, by means of the reforms carried out by the PSLRA[1654], prescribes an outspoken prolonged period of time, being 90 days

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[1650] *Ibid.*745 (referring to an "*in terrorem*" effects as a result of "allowing open-ended and unpredictable liability"). BLACK counters this argument pointing out that in order to preclude excessive liability, damages have been capped since the enactment of the PSLRA. Moreover, according to BLACK, the adoption of additional caps or limits by the courts goes beyond congressional intent and policy. It should be noted however that the cap imposed by the PSLRA is muddled and confused, as BLACK also acknowledges (BLACK, 'Reputational Damages', 180). Yet even in case a more sound system to cap the damages would be installed, this would still imply that the circle of licit plaintiffs is considerably expanded. Hence, more plaintiffs will be entitled to smaller compensation, while more complicated litigation is likely given the controversy and difficulties related to collateral damage, its existence and impact. BLACK correctly observes that correct and reliable financial information are key to the development and well functioning of markets, albeit as SEN and DUNBAR note, it seems that private enforcement of this kind of vague and elusive losses may not be the most appropriate instrument to ensure market integrity and soundness of financial disclosures given the difficulties it causes. Alternatively, as SEN and DUNBAR also observe, it should not be forgotten that the public authorities have a crucial role to play with regard to the protection of market integrity. See BLACK, 'Reputational Damages', 176; DUNBAR and SEN, 'Counterfactual keys', 241.

[1651] CORNELL and RUTTEN, 'Collateral damage', 738, 745. Albeit divided on the matter, the prevailing opinion in the (predominant US) literature opposes the recoverability of this kind of losses for various reasons based upon both the rationale and the black letter requirements the US securities laws, an insufficient causal link between the alleged wrong and the claimed loss and policy considerations. As arguments derived from interpretations of the US statutory provisions bear limited relevance to the question outside a US context, we do not elaborate on this topic but refer contributions offering an analysis of the legal requirements for investor compensation under US securities law See for instance: CORNELL and RUTTEN, 'Collateral damage', 738 ff.; LEV and DE VILLIERS, 'Stock Price Crashes', 22 (with regard to the crash component in stock price drops). Both contributions conclude that respectively collateral losses or crash components are not recoverable in the light of Rule 10b-5 and the congressional intent underlying the legal provision. Reaching the opposite conclusion based on the overarching aim of the US securities laws to protect market integrity, BLACK however reaches the opposite conclusion holding that reputational losses as it is termed in the contribution cannot be considered irrecoverable in the light of the statutory law. See: BLACK, 'Reputational Damages', 180.

[1652] To our knowledge, no case law from European courts dealing with these thorny questions has yet been reported. Although European literature on the topic has remained relatively scarce so far also, some commentators have mentioned the problem of recoverability of overreactions. See for instance: (The Netherlands) DE JONG, *Schade door misleiding*, 189-191, asserting that losses due to panic reactions should be recoverable as a matter of principle; (France) SPITZ, *La réparation*, 270, opposing the recoverability of losses following overreactions asserting that crashes and bubbles, as well as panic influencing the prices are investment risk to be borne by the investor. (Germany) FLEISCHER, 'Inhalt des Schadensersatzanspruchs', 1874, suggesting to apply bounce back periods to isolate losses due to overreactions; similar: BARTH, *Schadensberechnung*, 243; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 112-113. *Contra*: HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 132. It is argued that price depreciations following revelations of misreporting, yet not directly linked to the misreporting but instead caused by reputation loss ('*Skandalschaden*') and other collateral losses, are also caused by the misreporting and hence recoverable according to §§37b, c WpHG. HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 107 defining and describing these losses, para. 132 arguing its recoverability under §§37b, c WpHG.

[1653] HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 139.

[1654] See with regard to the PSLRA (Private Securities Litigation Reform Act, enacted in 1995): *supra*, ftn. 1412.

following market realization.[1655] Since a period stretched over a period that long is likely to include price effects entirely unrelated with the initial fraud or misrepresentation that may either worsen or improve the situation entirely independently from the fact that misrepresentations occurred, it seems more prudent, fair and correct to set a shorter period of time, going from several days to a couple of weeks.[1656] This period could either be fixed by a statutory initiative or left to the discretionary assessment of the court, which may rely on experts.[1657]

b. In and out trades: offsetting gains and losses

485. Once the damage per share has been calculated, possibly by means of an event study as discussed earlier, the recovery per individual investor must be determined. A fundamental principle in this regard is that investors should not be entitled to redress either below or exceeding the loss they suffered as a result of the defendant's wrongdoing. Hence, on the individual level, it is necessary to determine the net loss suffered by an investor who has sold or purchased securities at distorted prices. One specific element to take into account in this regard is the possibility of investors who traded in the securities during the time of the misrepresentation and sold and (re)purchased at various points in time. This is also referred to as 'in and out trades' (or out and in trades for that matter).[1658] It was already clarified that an investor who purchased securities at an inflated price, yet sells again before the inflation has dissipated, is not entitled to redress. Similarly, an investor may also sell securities against a deflated price and purchase the very same security again before the deflation has dissipated. Provided that the deflated part of the sale and purchase price match and even out each other, the investor-plaintiff has suffered no net losses and should not be entitled to recovery, similar to the aforementioned scenario in which an investor purchases and sells against equally inflated prices.[1659] In and out trades need to be balanced in other words to determine whether an actual loss has been suffered.[1660]

[1655] S.21D (e) (1) SEA 1934 (15 USC § 78u 4(e)(1) (2006)). See Addendum III at the end of this chapter with regard to the text of the provision. See also: LOWENFELS and BROMBERG, 'Compensatory damages', 1112-1113; S. CHOI and A.C. PRITCHARD, *Securities regulation: the essentials*, New York, Aspen Publishers, 2008, 144-145; COX, HILLMAN and LANGEVOORT (eds.), *Securities Regulation*, 729-730; BLACK, 'Reputational Damages', 180.

[1656] DE JONG, *Schade door misleiding*, 205. Asserting that the price effect of overreactions should be filtered out, DE JONG proposes a bounce back-rule with a period of 10 to 20 days. LEV and DE VILLIERS suggest a term of several days to a week or two: LEV and DE VILLIERS, 'Stock Price Crashes', 35.

[1657] Idem.

[1658] ALEXANDER, 'Value of Bad News', 1432; FISCH, 'Cause for Concern', 858 and references cited. With regard to situations in which in and out trades frequently occur: consult and some examples, see more extensively: FRANCIS, 'Meet Two-Face', 3049-3051. See also the references to case law cited in the contribution, particularly at 3064-3078. See specifically with regard to short selling also: DE JONG, *Schade door misleiding*, 145.

[1659] US case law offers some examples: Centaur classic convertible arbitrage fund Ltd., et al, v. Countrywide Financial Corporation et al., 793 F.Supp.2d 1138 (C.D. Cal. 2011), at 1143-1144; Rocker Mgmt., LLC v. Lernout & Hauspie Speech Prods. N.V., 2007 WL 2814653 (D.N.J., 2007); Blackie v. Barrack, 524 F.2d 891, 907 (9th Cir. 1975), cert. denied, 429 U.S. 816 (1976), at 908-909; Arenson v. Broadcom Corp., 2004 WL 3253646 at *1-2 (C.D.Cal., 2004); Richardson v. TVIA, Inc., 2007 WL 1129344, at *4 (N.D.Cal., 2007); Johnson v. Dana Corp., 236 F.R.D. 349, 352-53 (N.D.Ohio, 2006); In re Mills Corp., 2006 WL 2035391, at *3 n.1 (E.D.Va., 2006). For an extensive and detailed discussion on the matter, consult: FRANCIS, 'Meet Two-Face', 3045.

[1660] LEFLER and KLEIDON, 'Just How Much Damage Did Those Misrepresentations Actually Cause', 300; DE JONG, *Schade door misleiding*, 129. The latter authors provide further clarification on the method to calculate the net loss due to price distortion in case a chain of transactions has taken place. With regard to the method see also: In re Cable & Wireless, PLC Securities Litigation 217 F.R.D. 372 (E.D.Va. 2003) at 378-379; In re Bausch & Lomb, 244 F.R.D. 169, 173 n.4 (W.D.N.Y. 2007); Rocker Mgmt., LLC v. Lernout & Hauspie Speech Prods. N.V., 2007 WL 2814653 (D.N.J., 2007) at 14-15 offering an overview of the methodology options and references to cases applying one of those. The court also holds that the methodology is to be determined in the light of the circumstances since it is a fact-sensitive inquiry, best accomplished on a

c. *Traditional limitations: contributory negligence, and loss mitigation*

486. Traditional limitations on damages following contributory negligence and the obligation to mitigate the loss once is has emerged generally do not apply in the market model. All losses incurred as a result of price distortions following misreporting are recoverable, losses related to other events or market tendencies on the other hand are to be borne by the investor himself since there is no causal link with the misreporting. Whether the investor retains the securities following corrective disclosures is irrelevant in the light of the scope of the damages since no further price fluctuations matter once the distortion has been rectified.[1661]

C. Interim conclusion: the concept and calculation of recoverable loss in the market based-approach

487. The analysis of the employment of the market model appears a feasible and valid alternative in the light of the analysis of the model and the calculation of damages under this model. The market model neutralizes the (evidential) difficulties related to the transaction model, mostly because the model is modeled to the interaction between information and price formation in open market transactions. A shift also takes place from the subjective assessment of how certain pieces of information affected an investment decision for each and every investor involved, towards a model that focuses on the manipulation of the price supported by expertise and regression procedures in order to objectify the existence and calculation of losses caused by misrepresentations.

488. The market model may hence offer a valuable alternative to the transaction model, yet some questions remain. For instance, so far, the analysis focused on secondary market transactions effectuated against distorted prices. Yet it may be worthwhile to examine the use and operation of the market model with regard to misleading prospectus information too. Secondly, under the market model, all investors trading in the relevant time period are being deceived with regard to the price of the securities they are trading, regardless of investor profile, risk appetite, investment objectives and intentions, sophistication and the like. This simplifies the process of investor compensation, but also raises the question with regard to the possibility (or need) to employ collective procedures. Lastly, we also examine if and to what extent the employment of the market model may contribute to the effectiveness of private enforcement of securities laws.

V. Applicability of the securities pricing model to prospectus liability cases

489. The preceding sections analyzed the possibility and implications of the application of the price causation model as a means to solve the problematic establishment of reliance in court to obtain recovery for losses suffered following secondary market information.[1662] Notwithstanding the fact that

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case by case basis. See also extensively on this topic: FRANCIS, 'Meet Two-Face', 3045, and with regard to methods to offset gains and losses 3065 ff. in particular.

[1661] In a similar sense: HABERSACK, MÜLBERT and SCHLITT, *Handbuch der Kapitalmarktinformation*, §30, para. 152; FUCHS and BOUCHON (eds.), *Wertpapierhandelsgesetz*, §§37b, c WpHG, para. 36; *But*: DE JONG, *Schade door misleiding*, 220 ff. The author advocates the use of contributory negligence in this context.

[1662] Note that the price causation model – in the form of the FOM-doctrine – has been developed by the US with a focus on secondary market information since the evidentiary problem the courts sought to solve did not occur to a comparable extent with regard to liability following misrepresentations in the registration documents. This the logical consequence of the fact that under s.11 and s.12 Securities Act specific and tailored liability regime have been designed for suits following primary market transactions differ in various respects from secondary market transactions, however, it may be worthwhile to inquire whether the causation model may serve as a valuable alternative model in the context of prospectus liability cases too. Two questions arise in that regard. First, the application of the securities pricing model requires that the price of the securities offered is affected by incomplete or inaccurate information. Since initially offered securities do not trade on liquid secondary markets where expectations and available information have influenced the price for which these securities are traded, the question must be asked how the price – usually set by underwriters – can be impacted by erroneous prospectus information. Secondly, it has been demonstrated in the previous chapter that statutory regimes aimed at facilitating prospectus liability claims have been enacted in various Member States. The question arising in this regard concerns the compatibility as well as the added value of the market model when taking the existing prospectus liability regimes into account.

490. Impact of (erroneous) prospectus information on the offering price. Prospectuses aim to provide the market with all relevant information on the issuer offering the securities, its business and prospects, its financial position, the securities offered, and so on. Furthermore, the information must be presented in an orderly fashion, allowing investors to compare the offer with rivaling offers. Based on the available information, investors decide not just whether to subscribe or not, but rather whether to subscribe at the offering price (or at a price within the predetermined price range) or rate (in case of bonds) set by the offerors.[1663] To attract and ensure sufficient market interest, the price or rate must thus correspond to the investor public's assessment of a reasonable and attractive product in the light of the available information. From this point of view, the underwriter's perception of a proper, reasonable offering is driven by what the market will consider a proper price, which is in turn dependent on the market's assessment of the information provided in the prospectus, as the latter is the first and foremost source of information for initially offered securities. Hence, prospectus information is vital to the determination of the offering price as it serves as a fundamental source of information on which the investors will rely to reach their decisions, and hence forges the link between those making the offer and those evaluating the offer.[1664] To the extent prospectuses omit or misrepresent information that may negatively impact the price, a higher offering price can be charged (or a lower interest rate in case of bonds) causing all those subscribing to the offering and all those purchasing those securities during the period of misrepresentation after the launch to do so at an inflated price.[1665]

491. Illustration: the book building process. – The relevance of prospectus information in the price setting process becomes even more apparent when taking a closer look at the price formation process of initially offered securities through the method of book building.[1666] The book building

misleading information in the context of an offering, including statutory presumptions of reliance and rules fixing the recoverable losses (comparable to the German statutory regime applicable to prospectus liability claims).

[1663] This obviously assumes that prospectus is read and comprehended by potential investors, an assumption that has been found invalid with regard to (large numbers) of retail investors (see *supra*: Part I, Chapter I, para. 18). The interaction between prospectus information and price setting hence seems limited to institutional and professional investors that actually read and process the information contained in prospectuses, and who are able to understand comprehend the often lengthy and technical information provided in these documents.

[1664] Similar: PANASAR and BOECKMAN, *European Securities Law*, 11, para. 1.26; NEWKIRK, 'Sufficient Efficiency', 1413.

[1665] P. LOSER, 'Financial crisis – The liability of banking institutions', 155.

[1666] Note that albeit book building has become the most frequently employed method to determine offering prices nowadays, alternatives such as Dutch auctions may be employed as well. Before the book building method became the most frequently used method, offering prices used to be fixed by underwriters. The fixed offering price method has lost considerable ground however to te benefit of book building. The most cited reason for this evolution concerns the fact that contrary to fixed offering prices, book building involves (far more) 'price discovery' efforts aimed at gaining insight on the potential investor demand for the offered securities. See for more details: R. GEDDES, *IPOs and Equity Offerings*, Oxford, Butterworthprocess more particularly implies that a price range is set – generally by the underwriter – with an upper and lower limit of what may be a plausible price. The bandwidth is communicated to potential subscribers through advertisements, the draft prospectus etc. Once the registration period has begun, potential subscribers will communicate the amount of shares they wish to subscribe to and the price they are willing to pay within the price range. These offers to subscribe are gathered by the underwriter (bookrunner) in the book. Once the registration closes, the subscription price is determined based on the orders received, followed by the actual allocation of the shares. The method of book building thus implies that the price is set based on what the investors are willing to pay, provided that their price ranges within the bandwidth set by the underwriter. To the extent the prospectus contains misleading information, it is possible that the potential subscribers were willing to pay a price higher than they would have been willing to do had they known the truth, and that the acquisition price determined following the building book thus is inflated.[1667] As a result, the instruments will be marketed against inflated prices causing all those subscribing to and trading in the instruments shortly after the offering to pay an inflated price, regardless of whether they actually read the prospectus or not.

492. Conclusion. – As prospectuses may be considered the first and foremost instrument on which sophisticated, institutional investors rely to decide on a subscription offer at the price or price range determined by the offerors, and since the latter set the price or price range corresponding to the (expected) market interest fostered by the available information, it is clear that interaction between prospectus information and price determination takes place. This was illustrated in the preceding paragraph using the bookbuilding procedure, but generally also applies to other pricing procedures as underwriters or other experts hired to advise on the determination of the offering price will generally rely on the whole of information available to set a price and end up being affected by possible misstatements or omissions. Institutional and other sophisticated investors, such as pension funds and insurance companies, may be willing to pay the price set by the offerors in (direct) reliance on the (misleading) information itself, while many other investors – and retail investors in particular – will not read or rely on the prospectus, but simply assume that the pricing is unimpaired by inaccuracies and subscribe against an inflated price too. For these reasons, the price causation model may be applied in the context of prospectus liability as well,[1668] provided however that this approach is compatible with statutory prospectus regimes enacted in several Member States.[1669]

493. Compatibility with (some of) the Member States' statutory prospectus regimes. Whereas some Member States simply apply the market model in the context of prospectus liability (e.g. UK),

Heinemann, 2003, 68 (mostly with regard to UK); with regard to the Netherlands: R.P.E. BARBAS and E. NIEUWLAND, 'Inschrijving, bookbuilding en toewijzing', B. BIERENS, C.M. GRUNDMANN-VAN DE KROL, D.J.R. LEMSTRA and T.M. STEVENS, *Handboek beursgang*, Deventer, Kluwer, 2011, 427, stating that book building is now the most frequently deployed method, whereas fixed offering prices have become rarely. In a similar sense: PH. ESPINASSE, *IPO: a global guide*, Hong Kong, Hong Kong University Press, 2011, 154; K. KUTSUNA and R.L. SMITH, 'Why Does Book Building Drive Out Auction Methods of IPO Issuance? Evidence from Japan', 17 *RFS*, 2004, iss. 4, 1129; J. C. COFFEE and H.A. SALE, *Securities regulation*, New York, Foundation Press, 2009, 92. See with regard to bookbuilding also: ARONS, *Cross-border Enforcement*, 53-54 and references cited.

[1667] ARONS and PIJLS, 'Prospectus liability in the Netherlands', 473-474; ARONS, *Cross-border Enforcement*, 78; DE JONG, *Schade door misleiding*, 142 ff.

[1668] See in this regard also: (the Netherlands) PIJLS, 'Het causaliteitsvereiste bij prospectusaansprakelijkheid', 185; DE JONG, Aansprakelijkheid, 652; (UK) ALCOCK, 'Misinforming the market', 251; (Belgium) RAVELINGIEN, Privaatrechtelijke handhaving, 812. See in this regard also: P. LOSER, 'Financial crisis – The liability of banking institutions', 155.

[1669] With regard to the measurement of the artificial inflation incorporated in the introduction price, the corrective drop – measured and further analyzed possibly through event studies – may be indicative of the inflationary part of the price and the recovery to which subscribers are entitled.

some other regimes are compatible with both the mispricing and the reliance model (e.g. Belgium and France), and yet others have excluded this possibility through enacting fixed damages based on the traditional approach (e.g. Germany). An example of a jurisdiction recovering losses through mispricing as a result of deficient prospectus information is the UK. As discussed earlier, the UK statutory regime laid down in s.90 FSMA 2000 dispenses the reliance requirement, while it is assumed that accordingly, damages are limited to losses resulting from the resulting mispricing.[1670] In Germany on the other hand, the recoverable loss has been fixed in statutory law and holds that investors entitled to the difference between the purchase price and the sale price, including losses unrelated to the misstatements as such, or in case they still own the securities, they can return those and receive the initial purchase price back.[1671] This regime does not offer room for a different concept of recoverable loss. In Belgium and France, the loss is to be determined in accordance with the general liability rules, which generally leave room for an alternative concept of loss. In the Netherlands, the situation appears rather confused following the most recent decision handed down by the Dutch Supreme Court in World Online.[1672] In the literature however, the dominant view is that mispricing losses are recoverable under the Dutch prospectus liability regime.[1673]

494. By comparison, according to the US (statutory) rules, the recovery measure for losses suffered following misrepresentations in the context of initially offered securities depends on the applicable statutory rule, and more particularly on whether it concerns misrepresentations in registration statements (s.11 US Securities Act) or prospectuses (s.12 Securities Act). According to s.11 US Securities Act, investors are entitled to damages equal to the difference between the purchase price and the value at the moment of filing, provided that this may not exceed the initial offering price. In case the securities have been sold, the difference with the sale price is the measure of recoverable loss, yet again provided that his does not exceed the initial offering price. The defendant may however present evidence that (part of) the price decline represents the effect of unrelated factors, such as general market tendencies or the like. Hence, to the extent that the drop has been caused by unrelated events and provided that the defendant succeeds to establish evidence in this respect, the loss recovered by the investor-plaintiff is limited to the mispricing loss.[1674]

VI. The case for collective redress mechanisms in EU Member States

495. It was demonstrated that the concept of recoverable loss differs depending on whether one claims that his investment decision has been distorted, or the price of the securities at matter has been affected by the misrepresentation. Whereas the simple rescissory measure entitles the individual investor to his initial investment amount – potentially increased with foregone profits – in the first scenario, mispricing damages are limited to the extent of the price distortion vis-à-vis every claimant-

[1670] HUDSON, *Securities Law*, 642, para. 24-81; ALCOCK, 'Misinforming the market', 251; GORE-BROWNE, *Gore-Browne on companies*, section chapter 43, [4]; DAVIES and WORTHINGTON, *Gower and Davies' Principles*, 931, para. 25-31, in conjunction with ftn. 141. See also P. LOSER, 'Financial crisis – The liability of banking institutions', 155, noting that both the UK and Switzerland apply price causation in the context of prospectus liability (references to Swiss case law cited in ftn. 131).

[1671] §21 WpPG (former §§44-45 BörsG). See *supra*, para. 351.

[1672] DE JONG, *Schade door misleiding*, 143-145.

[1673] ARONS and PIJLS, 'Prospectus liability in the Netherlands', 473-474; ARONS, *Cross-border Enforcement*, 78; DE JONG, *Schade door misleiding*, 142 ff.; PIJLS, 'Het causaliteitsvereiste bij prospectusaansprakelijkheid', 185; DE JONG, Aansprakelijkheid, 652.

[1674] A similar arrangement is provided in s.12 US Securities Act, with the difference of a restitution option in case the investor-plaintiffs still hold the securities. See also *supra*, ftn. 1300.

investor who has traded within the relevant time period. Two notable observations can be made in this regard. First of all, applying a notion of loss based on the distortion of an individual investment decision will generally result in a relatively larger amount of recoverable losses than losses based on price distortions, which will be smaller.[1675] Secondly, whereas the first approach focuses on individual investment decisions, the market model focuses on price distortion suffered by a few dozen over a couple of hundreds to potentially even thousands of investors who suffered losses in comparable circumstances regardless of individual singularities that may have impacted or caused investment decisions being taken. These two factors together, being the similarity of a potentially wide range of claims and the fact that the individual claims typically have relatively modest value, inevitably leads to question if and what role collective redress mechanisms can play. More particularly, when brought on an individual basis, considerable costs will have to be borne by each investor. Since compensations are more modest under the market model however, investors will be more inclined to forego the possibility to file claim because the costs will dwarf the expected proceeds more frequently. This phenomenon is often referred to as 'rational apathy'.[1676] In those cases where a claim might pay off on the other hand, the mass of individual claims is likely to clog the courts with lengthy, expensive and burdensome (replicating) procedures as a result. From this perspective, it seems clear that the possibility to proceed on a collective basis may contribute significantly to the efficiency, effectiveness and overall economic viability of the market model.

496. Contrary to the US, however, EU Member States generally lack a deep rooted experience with collective actions. For some years however, the scene in Europe has been evolving towards a pronounced interest in designing a sound and distinct collective redress system for small (consumer) claims predominantly in the field of competition and consumer law, but also with regard to capital market and financial law. The increasing interest for collective redress mechanisms has resulted in initiatives undertaken at both EU and member state level. At the EU level, various papers, studies, consultations and other documents have been launched, aimed at assessing the problems consumers face in obtaining redress for low value (mass) claims and the economic consequences thereof for the single market in terms of obstacles for cross-border retail services and activities and distortions of competition. [1677] Based on these studies and consultations, the European Commission has concluded that measures ensuring an efficient and coherent handling of mass consumer claims are advisable. The

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[1675] Whereas the autonomy investor model is based on the assumption that erroneous information distorted investor's choices allowing investors to recover damages according to the rescissory measure, damages under the price causation model only remedy the price distortion resulting from the misinformation. See also in this regard: WAGNER, 'Schadensberechnung', 495: HELLGARDT and KOWALEWSKI, 'Stand der Rechtsprechung', 1840 (comparing the scope of damages in German capital market law: "*Kursdifferenzschaden*" and "*Vertragabslussschaden*").

[1676] S. KESKE, A. RENDA, and R. VAN DEN BERGH, 'Financing and Group Litigation, in M. TUIL and L. VISSCHER (eds.), *New Trends in Financing Civil Litigation in Europe*, Cheltenham, Edward Elgar, 2010, 59 ff.; P. LOSER, 'Financial crisis – The liability of banking institutions', 159.

[1677] European Commission, EU Consumer Policy Strategy for 2007-2013, COM (2007) 99 final, available at http:\\ec.europa.eu, p. 11 in particular; European Commission, Green Paper On Consumer Collective Redress, 2008, COM(2008) 794 final, available at: http://ec.europa.eu/, 15; European Commission, Consultation: Follow-up to the Green Paper on consumer collective redress, 2009, available at http://ec.europa.eu/, 28; European Commission, Public Consultation: Towards a coherent European approach to Collective Redress, 2011, SEC(2011)173 final , available at http://ec.europa.eu/, 13; and various studies such as European Commission, Consumer Redress in the European Union: Consumer Experiences, Perceptions And Choices, 2009, 120; European Commission, Study regarding the problems faced by consumers in obtaining redress for infringements of consumer protection legislation, and the economic consequences of such problems, Final Report 2008, available at http://ec.europa.eu/, 204; European Commission, An analysis and evaluation of alternative means of consumer redress other than redress through ordinary judicial proceedings, Final Report, 2007, available at http://ec.europa.eu/, 415 p. For an overview and discussion of the EU initiatives, see also: D. FAIRGRIEVE and G. HOWELLS, 'Collective redress procedures: European debates', D. FAIRGRIEVE and E. LEIN, *Extraterritoriality and collective redress*, Oxford, Oxford University Press, 2012, 36 ff.

European initiative resulted in a (non-binding) recommendation in 2013, which recommends the Member States to provide for collective redress mechanisms in various areas of EU law, including financial services, to enable EU citizens to enforce the rights granted to them under EU law.[1678] The actual creation and architecture of an EU-wide collective redress system has proven to move at a rather modest pace, as Member States tend to fend off European initiatives with considerable (binding) impact on national procedural law.[1679]

497. Hence, legislative efforts regarding mechanisms for collective redress at an EU level have so far predominantly focused on out of court-mechanisms, and more particularly, alternative dispute resolution ("ADR").[1680] Although enhancing out-of-court solutions for (consumer) disputes is definitively laudable for procedures are generally less costly, less lengthy and more easily accessible, it is yet unlikely that they can substitute for judicial remedies.[1681] Contrary to judicial remedies, ADR solutions are generally only binding on the parties to the extent they have consented to proceed claims through an ADR-system and recognize the solution as binding.[1682] It seems therefore unlikely that ADR can serve as a sufficient substitute for binding and enforceable judicial decisions that can be imposed unconditional from the parties' own agreement. From this perspective, ADR may prove a very valuable and useful supplement, yet it cannot replace in-court remedies as it does not provide parties with a credible threat in a system where no judicial remedies are available.[1683]

498. In-court collective redress initiatives on the other hand have progressed at a slower pace, the last initiative being a non-binding recommendation launched by the Commission in 2013[1684], which

[1678] Commission Recommendation on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law, 2013/396/EU, 11 June 2013, *OJ* L 201/60. See also: Commission communication "Towards a European Horizontal Framework for Collective Redress", COM(2013) 401/2, June 11, 2013.

[1679] For an overview of the EU background, consult for instance: S. VOET, 'Cultural dimensions of group litigation: the Belgian case', 41 *Ga. J. Int. Comp. Law*, 2013, iss. 9, 435; J. STUYCK, 'Enforcement and class actions in the area of financial transactions? Comments from a European perspective', in S. GRUNDMANN and Y.M. ATAMER, *Financial services, financial crisis and general European contract law*, Alphen aan den Rijn, Wolters Kluwer, 2011, 299.

[1680] ADR is a term encompassing various out of court-techniques to solve disputes and generally involves a neutral third (mediator, arbitrator, ombudsman, etc.) party to mediate between parties. See in this regard for instance: Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC, *OJ* L 165/63 (Consumer ADR Directive); and Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC, EC, *OJ* L 165/1 (Consumer ODR Regulation).

[1681] HODGES for instance argues that ADR might be a better suited model for collective redress in Europe than in-court collective actions. C. HODGES, 'Modes of Redress for Consumers: ADR and Regulation', 2012, Oxford Legal Studies Research Paper No. 57/2012, available at SSRN: http://ssrn.com/abstract=2126485, 15; extensively on ADR as a means to remedy financial consumers: S.F. ALI, *'Consumer Financial Dispute Resolution in a Comparative Context'*, Cambridge, Cambridge University Press, 2013.

[1682] The Consumer ADR Directive and Consumer ODR Regulation do not prescribe that participation by all parties is mandatory, nor is the result binding without the agreement of the parties involved. With regard to the Consumer ODR Regulation, see for instance: art. 9 (3) (a), requiring the parties to agree on the competent ADR entity, if not, the complaint submitted by a consumer cannot proceed; or art. 9 (5) (e) stating that the parties need to be informed on the binding or non-binding nature of the outcome of the ADR-procedure). With regard to the Consumer ADR Directive, see for instance rec. (49); art. 10 requiring that in order to be binding, the parties must have been informed of the binding character of the procedure well in advance, and must have accepted this. The Directive also clearly states that the ADR procedure should not serve as a replacement of in-court nor deprive parties of their right to seek judicial remedies (rec. (45)).

[1683] See for a similar conclusion: SPITZ, *La réparation*, 367, para. 588.

[1684] Commission Recommendation on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law, 2013/396/EU, 11 June 2013, *OJ* L 201/60. And: Commission communication "Towards a European Horizontal Framework for Collective Redress", COM(2013) 401/2, June 11, 2013. See in this regard also: S. VOET, European Collective Redress Developments 2013, August, Available at SSRN:

was preceded by a public consultation (launched in 2011) that aimed to identify common legal principles on collective redress throughout the various Member States.[1685] Civil procedure is a rather untried area of EU reform however, and has even been further complicated by the fact that various Member States have adopted national group action procedures styled after different models.[1686] Policy choices spurring debate and causing national procedures to differ include the choice for opt out or opt in-rules, the role of lead plaintiffs as opposed to leading organizations and/or the role of (leading) attorneys, the funding of the class action (and contingency fees in particular)[1687], the loser pay-rule (English rule) or the principle that each party bears its own costs regardless of the outcome (American rule). The English and German group action procedures for instance are based on a similar model that consists of three phases, the first being an individual phase in which the plaintiff files suit and may request collective treatment with regard to questions common to the group.[1688] Only those plaintiffs who file suit or register their claim after a notification has been issued, are included in the group action (opt in-model). If a number of suits with common factual and legal questions are being filed, one and the same court can decide on general and isolated common matters in a second phase of the procedure (e.g. did the prospectus contain erroneous information). The decision on general common questions is then binding vis-à-vis those included in the procedure. In a third phase, the individual procedures between the parties involved are continued and decided on an individual basis (e.g. damages, contributory negligence, etc.).

499. The Italian model on the other hand leans closer to the US example and consists of an admissibility stage, comparable to the US class certification, and is followed by the liability and

http://ssrn.com/abstract=2318809, 20p.; R. DEUTLMOSER, 'Die Büchse der Pandora: Kollektiver Rechtsschutz in Europa', 24 *EuZW*, 2013, heft 17, 652.

[1685] EC, Public Consultation: Towards a coherent European approach to Collective Redress, 2011, SEC(2011)173 final , available at http://ec.europa.eu/, 13.

[1686] Confronted with the emergence of mass claims that could not adequately be dealt with on an individual basis, several Member States and other European countries responded by enacting collective procedure regimes. Notable examples include Germany (where the collective action was introduced after around 15.000 claims were filed by disgruntled shareholders against Deutsche Telekom for misleading prospectus information), Italy (in a reaction to the corporate Parmalat scandal, and to a lesser extent the *Cirio* case), and the Netherlands (the case against Royal Ahold functioned as a catalysator). Other countries that have enacted collective actions include Sweden, England and Wales, Denmark and Norway. For an overview of the aforementioned and other (European) countries: FAIRGRIEVE and HOWELLS, 'Collective redress procedures: European debates', 19 ff.; P.G. KARLSGODT (ed.), *World Class Actions*, Oxford, New York, Oxford University Press, 2012, chapter 5 to 18.

[1687] The contingency fee is a notable point of discussion in. Whereas some Member States apply or consider to apply contingency-based systems, most EU jurisdictions prohibit lawyers in one way or another to be compensated on a 'no cure, no pay'-basis. Opposing views are observed throughout the Member States in this regard. See in this regard for instance the Dutch proposal launched by the Second Chamber of the Dutch Parliament to start the debate on contingency fees in the Netherlands, motivated by the belief that contingency fee-based systems may increase the access to the judiciary (*Kamerstukken II*, 2012-2013, 31753, nr. 61, https://zoek.officielebekendmakingen.nl/kst-31753-61.html). The contingency fee has also been made possible in the UK since 2013. See: J. COHEN, 'Costs reforms to the civil justice system in England and Wales', 28 *JIBFL* 2013, nr. 5, 292. Other Member States consider contingency fees problematic and prohibit this kind of remuneration. For example, With regard to Belgium, VOET notes that contingency fees are "incompatible with an attorney's professional ethics" VOET, 'Cultural dimensions of group litigation', 467. See with regard to the application of contingency fees in the EU also: S.M. GRACE, 'Strengthening investor confidence in Europe: US style securities class actions and the acquis communautaire', 15 *J. Transnat'l L. & Pol'y*, 2006, iss. 2, 287.

[1688] A notable difference between the English and the German group actions concerns the scope of the regulation. Whereas the English action has a general scope (Group Litigation Order or "GLO"), the German group action is only applicable to injured investors in the context of capital market law violations, including prospectus liability, continuous reporting obligations and misleading investment advice. See for an overview of the German and English procedure also: FAIRGRIEVE and HOWELLS, 'Collective redress procedures: European debates', p. 26 ff. with regard to Germany, p. 28 ff. with regard to England and Wales. See for England and Wales also: J. SORABJI, 'Collective action reform in England and Wales', in D. FAIRGRIEVE and E. LEIN, *Extraterritoriality and collective redress*, Oxford, Oxford University Press, 2012, 43 ff.; L. HARBOUR and J. EVANS, 'The United Kingdom', in P.G. KARLSGODT (ed.), *World Class Actions*, Oxford, New York, Oxford University Press, 2012, 169 ff.

damages phase.[1689] The first stage concerns an admissibility review and a prima facie examination of the merits of the case. Once found admissible, a notification is sent out allowing other parties to join the action during a limited period (opt in-model). In the second phase of the procedure, the merits of the case will be assessed and in case the defendant is found liable, the amount of damages to be awarded is determined. The decision is binding to all those who opted in. The Dutch model by contrast provides for two collective redress mechanisms, being a system for collective actions to be litigated in court on the one hand[1690], and a collective settlement to be declared binding by court on the other.[1691] The collective action is to be initiated by an association or foundation representing a group of individuals who have actively entrusted the representative organization to initiate proceedings on their behalf (opt in-model).[1692] In the context of capital market law, collective claims are generally initiated by investor associations such as *Vereniging Effectenbezitters* (VEB), consumer organizations, and ad hoc vehicles set up to bring a collective action. The court is to decide on the legal standing of the organization bringing the claim, and particularly whether it seeks to protect the common interests of its members. The court can however not award monetary damages to individual members of the collective action, nor can it decide on other individual matters. The action is instead mostly used to obtain a declaratory decision on the alleged breach by the defendant, following which individual members can file individual claims for damages, with reference to the collectively established breach. In general however, defendants often settle after the court declared they breached the law.[1693]

500. Alternatively, the Dutch law also offers the possibility to settle the dispute collectively, again by means of an organization or foundation representing its members. This procedure consists of two phases, the first consisting of negotiations between the parties aimed at reaching a settlement agreement. If agreement is reached, the settlement can be brought before the court, being the Amsterdam Court of Appeal, assessed on its conformity with the law and eventually declared binding to all those who did not expressly declared to opt out of the class. The collective action and collective settlement procedure can be used separately or combined.[1694] For instance, a declaratory judgment may be sought through a collective action, inducing the parties to settle afterwards instead of proceeding on

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[1689] R. NASHI, 'Italy's Class Action Experiment', 43 *Cornell Int'l L.J.*, 2010, 147; FAIRGRIEVE and HOWELLS, 'Collective redress procedures: European debates', 26, para. 2.37-2.38; S. ENNE, 'Italy', in P.G. KARLSGODT (ed.), *World Class Actions*, Oxford, New York, Oxford University Press, 2012, 334 ff.

[1690] Art. 3:305a-c DCC. I. TZANKOVA and H. VAN LITH, 'Class actions and class settlements going global: the Netherlands', D. FAIRGRIEVE and E. LEIN, *Extraterritoriality and collective redress*, Oxford, Oxford University Press, 2012, 71, para. 4.17-4.18; W.J.L. DE CLERCK, J.D. ROTENBERG and J.-P. DOUGLAS-HENRY, 'International class actions: will the centre of gravity shift from the US towards Europe', 9 *European Company Law*, 2012, no. 3, 174; T.M.C. ARONS and W.H. VAN BOOM, 'Beyond Tulips and Cheese: Exporting Mass Securities Claim Settlements from the Netherlands', 21 *EBLR* 2010, no. 6, 862; J. FLEMING and J.J. KUSTER, 'The Netherlands', in P.G. KARLSGODT (ed.), *World Class Actions*, Oxford, New York, Oxford University Press, 2012, 288.

[1691] See for the Dutch Act on Collective Settlement Mass Damages: Wet collectieve afhandeling massaschade van 23 juni 2005, Stb. 2005, 340 (or "WCAM"). TZANKOVA and VAN LITH, 'Class actions and class settlements going global: the Netherlands', 72, para. 4.19-4.24; ARONS and VAN BOOM, 'Beyond Tulips and Cheese', 857; FLEMING and KUSTER, 'The Netherlands', 289.

[1692] Prior to filing the claim, the representative organization is required to inform the prospective defendant and attempt to settle the claim for at least two weeks. Courts have assessed the fulfillment of this admissibility requirement with lenience and flexibility. See in this regard: DE JONG, *Schade door misleiding*, 72; TZANKOVA and VAN LITH, 'Class actions and class settlements going global: the Netherlands', 71, para. 4.18.

[1693] See for instance the procedure initiated by VEB against *World Online* in the aforementioned proceedings following misleading prospectus information. After the court decided on the common questions of law and fact and the defendant was found to have breached the prospectus rules, the parties settled the case. HR 27 November 2009, *JOR*, 2010/43 with annotation by K. FRIELINK (*World Online*); *RvdW* 2009, 1403; *Ondernemingsrecht* 2010, 21, with ann. by H.M. VLETTER-VAN DORT.

[1694] TZANKOVA and VAN LITH, 'Class actions and class settlements going global: the Netherlands', 74, para. 4.25 ff.

an individual basis for damages. The settlement can then be declared binding by the Amsterdam Court of Appeal. The Dutch settlement agreement-procedure has proven one of the most successful procedures so far, particularly in the area of financial law. Its success has surpassed the Dutch borders as foreign investors appear to have turned to the Dutch jurisdiction to conclude collective settlement agreements and have it declared binding by the Dutch courts.[1695]

501. Other Member States, such as Belgium and France are also considering legislative proposals aimed at the facilitation of collective actions.[1696] In other words, the Member States have not awaited further EU initiatives and went ahead with adopting their own regimes with modalities based on their own insights, priorities and concerns. As a result, an EU-wide class action based on common ground between the Member States is no evidence, as illustrated by the Dutch government's suggestion to focus on best practices and coordination between the Member States, rather than replacing the national laws by a uniform EU model.[1697] The feasibility and contours of a potential EU-wide class action thus remain vague, although it has been observed that the debate also revealed at least one widely shared concern amongst policymakers and commentators within the EU, being a common resistance against the implementation of what is commonly referred to as the US-style class action.[1698] Instead, the prevailing opinion supports the design of a European class action modeled on European (common) concepts, and particularly resists rules or concepts typical to US class actions but yet unfamiliar to EU Member States, not in the least because these rules have been perceived to contribute to alleged abusive practices.[1699]

VII. The market based-approach assessed on its merits: effective redress and deterrent effect

[1695] See for instance the Converium settlement concluded according to the Dutch collective procedure and involving a Swiss company of which the shares were listed on the SWX Swiss Exchange and (in the form of American Depository Shares) on the US NYSE. Those investors that were American or had purchased the shares on the NYSE were allowed to proceed in the US. Those who were not American and had not traded on NYSE were excluded following the US Supreme Court's ban on F-cubed securities claims following *Morrison*. These investors instead turned to the Netherlands to reach settlement in a collective procedure. The increasing use of the Dutch collective procedure beyond its national borders has caused some to consider it an appealing alternative for European investors who have been barred from using the US class action following *Morrison*. See for instance: *Ibid*., 77, para. 4.37 ff.; PALMISCIANO, 'Going Dutch', 1847; ARONS and VAN BOOM, 'Beyond Tulips and Cheese', 857; DE CLERCK, ROTENBERG and DOUGLAS-HENRY, 'International class actions: will the centre of gravity shift from the US towards Europe', 174; C.A.J. VAN YPEREN, 'Converium deel II: zesde verbindendverklaring van een collectieve schadeovereenkomst met toepassing van de Wcam', *V&O* 2012, nr. 3, 11.

[1696] In France, legislative initiatives seem underway as well. See in this regard: Projet de loi relatif à la consommation (EFIX1307316L), available at: http://www.legifrance.gouv.fr. The introduction of collective redress mechanisms is also discussed in Belgium: VOET, 'Cultural dimensions of group litigation', 433.

[1697] See the Dutch government's response to the most recent public consultation on collective redress mechanisms launched by the Commission: 'Nederlandse reactie op de openbare consultatie over een coherent Europees kader voor collectief verhaal', 2011, available at http://www.rijksoverheid.nl/, p. 8 in particular.

[1698] See for instance the Green Paper On Consumer Collective Redress, 12, para. 48 stating that if the EU should provide a judicial collective redress procedure, it "should avoid elements which are said to encourage a litigation culture such as is said to exist in some non-European countries, such as punitive damages, contingency fees and other elements". A similar concern is expressed in the most recent consultation in this regard: Public Consultation: Towards a coherent European approach to Collective Redress, p. 9, mentioning contingency fees, punitive damages, discovery and absence of limitations on standing as elements that enable the occurrence of abusive litigation. See also VOET, 'Cultural dimensions of group litigation', 433, noting that "many European countries are struggling to craft procedural mechanisms to allow the resolution of group claims in a way that incorporates the helpful parts of U.S. class actions while avoiding its inefficiencies and potential abuses" (p.435). See also: GRACE, 'Strengthening investor confidence', 281, 285; D. CORAPI, 'Class actions and collective actions', D. FAIRGRIEVE and E. LEIN, *Extraterritoriality and collective redress*, Oxford, Oxford University Press, 2012, para. 1.43-1.45.

[1699] Idem.

502. The market model aims to align the legal approach to causation and damages in the context of issuer disclosures with market mechanisms, and particularly the interaction between wrongful information and pricing mechanisms. By removing the traditional and poorly suited reliance requirement and providing for a viable, well-adapted alternative model, the market model may promote and intensify private enforcement of mandatory securities disclosure violations (especially when combined with collective actions) and contribute to both the compensatory and deterrence function on which civil liability systems are principally predicated. However, whether and to what extent private enforcement of securities laws effectively attains these goals has been highly debated for over decades in the US and has remains unresolved. The criticism particularly asserts that the civil liability system that has originated from Rule 10b-5 has (too) little social value as it fails to realize its goals for various reasons (see below), whereas the costs associated with the system are significant.[1700] Although it has to be borne in mind that investor litigation in the US takes place in a considerably different setting compared to its European counterparts, we believe that some of the criticisms are not exclusively confined to the US setting and may emerge (at least to some degree) in the Member States too, should the Commission and/or individual Member press ahead with their plans to promote and reinforce civil liability as a means to enforce their financial laws more effectively. Hence, the question should be asked whether and to what extent the problems that have been the subject of criticism in the US may emerge in a European context too, and whether a strengthened reinforced private enforcement system is likely to contribute to the compensatory and deterrent function would of the system as a whole. It is noted from the outset that the criticism applies to private enforcement of securities laws in general and is not predicated on the market model in particular.

A. Circularity and limited recovery: the compensatory rationale undermined?

1. The circularity problem

503. Fairness argument. – The compensatory function of private securities litigation in the US has been challenged by the so-called circularity problem. Underlying the circularity problem is the finding that – regardless of whether corporate officials are jointly named as defendants – it is generally the issuer who foots the bill in the US, either directly or indirectly through insurance.[1701] Because shareholders are the actual owners of the corporation, issuer payment invariably comes at the expense of shareholders. Whereas this is not a unique feature or securities litigation as it is typical of each case of corporate or enterprise liability and has been favored over agents' liability for various reasons[1702],

[1700] See in this regard amongst many others for instance: COFFEE, 'Reforming Securities Class Action', 1534; M.B. FOX, 'Civil Liability and Mandatory Disclosure', 109 *Colum. L. Rev.*, 2009, 237; ROSE, 'Reforming Securities Litigation Reform', 1301; BRATTON and WACHTER, 'Political Economy', 69; J.C. ALEXANDER, 'Rethinking Damages in Securities Class Actions', 48 *Stan. L. Rev.*, 1996, 1487; J.E. FISCH, 'Confronting the Circularity Problem in Private Securities Litigation', *Wis. L. Rev.*, 2009, iss. 2, 333; LANGEVOORT, 'Capping Damages', 639.

[1701] COFFEE, 'Reforming Securities Class Action', 1550; A.M. ROSE and R. SQUIRE, 'Intraportfolio litigation', 105 *Nw. U. L. Rev.*, 2011, 1687; ALEXANDER, 'Rethinking Damages', 1499. The reason why issuers almost invariably end up paying the bill in the US and the role of insurance in this regard is elaborated on further below, but is can already be noticed that the US Supreme Court has traditionally barred liability of so-called 'secondary actors' (being aiders and abettors) who contributed, facilitated or participated in a scheme to defraud investors in the context of Rule 10b-5. See in this regard for instance: Stoneridge Investment Partners v. Scientific-Atlanta, 552 US 148 (2008).

[1702] Enterprise liability is the term used to indicate corporate liability for the actions of its agents, rather than holding the agents responsible for their actions conducted in the course of their duties. Enterprise liability has been traditionally favored over agents liability from a law and economics perspective for various reasons, such as optimal deterrence, and efficient risk allocation since entities – and thus the shareholders – have considerably larger risk-spreading capacity. More particularly, investors can diversify their investments, while corporate entities can generally take on more risk given their size and financial strength than individuals. Individual managers exposed to liability following errors committed in the course of their the case is different with regard to liability for secondary market misstatements.[1703] More particularly, whereas in many cases of enterprise liability, the company – and thus indirectly the shareholders – have enjoyed the benefit of the wrong, this is not the case with regard to misleading secondary market information.[1704] More particularly, as EASTERBROOK and FISCHEL pointed out in a seminal publication a few decades ago, contrary to securities offerings, issuers do usually not reap much direct gain from misstatements made with regard to secondary market transactions, contrary to securities offerings.[1705] Instead, losses suffered by investors trading at inflated or deflated prices are generally offset by the gain third party investors make as counterparty in these transactions. As a result, it has been considered unfair to pay out damages at the expense of 'innocent' shareholders who did not enjoy any of the benefits of the wrong.

504. Compensation argument. – In addition to the fairness argument, however, there is also a more fundamental concern as to the impact of circularity on the effectiveness of the system, and particularly the concern that the system fails to effectively compensate victimized shareholders. First of all, compensation paid out by issuers – at the expense of its shareholders – essentially results in a wealth transfer between two groups of shareholders, being the current group of shareholders of the defendant-company (on the paying side) and the group of former shareholders who purchased securities at an inflated price and either held or sold their securities (on the receiving end). To the extent that shareholders have retained their shares, there is an overlap between the paying and the receiving group of shareholders, implying that these shareholders are compensating themselves, yet at considerable transaction costs such as lawyers' fees, expert commissions, and other legal costs.[1706] From this perspective and vis-à-vis this group of shareholders who retained their shares, shareholder compensation is a zero-sum game that comes at considerable expenses.

505. Diversified investors. – Moreover, it has been asserted by some that when considering circularity from the angle of diversified investors over a prolonged period of time, investors are even more likely to be indifferent towards compensation since their chances of being on the winning side

duties may however behave very cautious – and potentially even overcautious to the detriment of the company – because of an unwillingness to take palatable risks when their personal assets may be at stake. See in this regard for instance EASTERBROOK and FISCHEL, 'Optimal damages', 641;: SHAVELL, *Foundations*, 234; S. SHAVELL, 'The Optimal Level of Corporate Liability Given the Limited Ability of Corporations to Penalize Their Employees', 17 *Int'l Rev L & Econ*, 1997, 203; Also, by forcing the shareholders of a company to bear the costs of their agents' wrongdoing, they are incited to monitor their agents and deter them from wrongdoing. See: R.H. KRAAKMAN, 'Vicarious and Corporate Civil Liability', M. FAURE, *Tort Law and Economics*, Cheltenham, Edward Elgar Publishing, 2009, 135 ff. For an overview of the literature and an application on securities fraud, consult: ARLEN and CARNEY, 'Vicarious Liability', 691.

[1703] *Contra:* COX and THOMAS countered the circularity critique arguing that the phenomenon of self-suing shareholders is not a unique characteristic of securities class litigation but a common feature of any lawsuit between companies owned by diversified shareholders. (J.D. COX and R.S. THOMAS, 'Mapping the American Shareholder Litigation Experience: A Survey of Empirical Studies of the Enforcement of the U.S. Securities Law', 6 *Eur. Company & Fin. L. Rev.*, 2009, 164) Hence, it follows from this finding that the criticism directed at the socially wasteful wealth transfer between groups of shareholders in the context of securities class actions equally applies to every situation in which diversified shareholders sue. *Compare*: DE JONG, *Schade door misleiding*, 229.

[1704] See in this regard also extensively: COFFEE, 'Reforming Securities Class Action', 1562.

[1705] EASTERBROOK and FISCHEL, 'Optimal damages', 641; also: LANGEVOORT, 'Capping Damages', 646; DAVIES, 'Liability for misstatements', 300; COFFEE, 'Reforming Securities Class Action', 1556; BLACK, 'Should the SEC', 322.

[1706] ALEXANDER, 'Rethinking Damages', 1503 ("To the extent that shareholders continue to hold their shares, payments by the corporation to settle a class action amount to transferring money from one pocket to the other, with about half of it dropping on the floor for lawyers to pick up"). Securities class actions obviously trigger procedural costs such as attorneys on both the plaintiff and defendant side. It is noted that these costs are generally considered substantial, for instance because in US securities class actions it is custom that plaintiff attorneys are paid around 30 percent of the settlement amount. Other costs incurred are insurance premiums to be paid for both the corporation and its corporate officials, the reputational loss, experts that are hired etc. See for instance: COFFEE, 'Reforming Securities Class Action', 1546; LANGEVOORT, 'Capping Damages', 650.

offset the chances to be on the losing end, though without having to pay any of the transaction costs that come with litigation.[1707] Although empirical research on circularity is scarce, some relevant insights on the merits of Rule 10b-5 – or rather how market participants assess the merits from the perspective of compensation – may be offered by recent research carried out in the aftermath of the US Supreme Court's decision in *Morrison*.[1708] The studies particularly attempted to measure the impact of the abrupt and unanticipated unavailability of Rule 10b-5 for foreign investors following *Morrison* and conclude that investors apparently do not really consider the game worth the candle, although the reason as to why this is felt is not apparent from the study.[1709] Another empirical study specifically aimed at investigating the existence and scope of circularity, however, found that investors – diversified and undiversified – do suffer losses as a result of secondary market misrepresentations.[1710] The study found that on average, only large diversified institutional investors suffer little misrepresentation related-harm since losses and gains effectively net out over time.[1711] Yet, this finding only attested this result for large diversified investors on an aggregate basis.[1712] More particularly, it was found that on balance, undiversified investors are exposed to considerable misrepresentation related-harm because their potential losses will not be compensated in a similar fashion. Second, the netting out of fraud-related gains and losses was assessed on an aggregate basis,

[1707] EASTERBROOK and FISCHEL, 'Optimal damages', 641. See also: DAVIES and WORTHINGTON, *Gower and Davies' Principles*, 962-963, para. 26-12; LANGEVOORT, 'Capping Damages', 646; ALEXANDER, 'Rethinking Damages', 1502; COFFEE, 'Reforming Securities Class Action', 1562; FOX, 'Civil Liability', 280; BRATTON and WACHTER, 'Political Economy', 76; D.C. LANGEVOORT, 'On Leaving Corporate Executives Naked, Homeless and without Wheels: Corporate Fraud, Equitable Remedies, and the Debate over Entity versus Individual Liability', 42 *Wake Forest L. Rev.*, 2007, 633.

[1708] The sudden and abrupt change regarding the extraterritorial reach of Rule 10b-5 in *Morrison* presented a natural experiment allowing for empirical analysis of the value market participants place on the possibility (or threat) to become involved in securities fraud class actions. Prior to *Morrison* a relatively flexible test was applied, allowing securities class actions claims involving non-US issuers to be brought in US courts under Rule 10b-5. Following *Morrison*, however, the application of Rule 10b-5 has been limited to claims involving securities listed and trading on US stock markets or securities purchased or sold within the US. LICHT, POLIQUIN, SIEGEL and LI analyzed the effect of the change in legal regime with regard to US-listed foreign firms that cross-list on a US and non-US stock exchange. With regard to the firms listed, it was examined whether a change in value had taken place following the change, being that they would be excluded from the Rule 10b-5 regime. With regard to the investors, it was analyzed whether the investors' trading behavior adjusted in response to the legal change. The analysis revealed that the change was met with indifference. N. A. LICHT, C. POLIQUIN, J.I. SIEGEL and X. LI, 'What makes the bonding stick? A natural experiment involving the US Supreme Court and Cross-Listed firms', 2011, http://www.sec.gov.edgekey.net. Their findings seem to be confirmed by similar research analyzing whether and to what extent institutional investors changed their trading pattern following *Morrison*, revealing an overall indifference with regard to these investors as to whether Rule 10b-5 applied or not. See: R.P. BARTLETT, 'Do Institutional Investors Value the 10b-5 Private Right of Action? Evidence from Investor Trading Behavior Following Morrison v. National Australia Bank Ltd. (2010)', 2012, UC Berkeley Public Law Research Paper No. 2171006. Available at SSRN: http://ssrn.com/abstract=2171006.

[1709] Idem.

[1710] A.V. THAKOR, S.J. NIELSEN and D.A. GULLEY, 'The Economic Reality of Securities Class Action Litigation', 2005, U.S. Chamber of Commerce Institute of Legal Reform, October 2005, available at: www.instituteforlegalreform.com, 37p. For the sake of completeness it should be mentioned that the study was prepared for the US Chamber of Commerce, which has advocated restrictions and even abandonment of US private securities litigation. The study has been criticized for various reasons as well, including imprecise calculations of the fraud-related gains and losses (A.D. EVANS, 'Are Investors' Gains and Losses from Securities Fraud Equal Over Time? Theory and Evidence', 2010, U of Michigan Law & Economics, Olin Working Paper No. 09-002. Available at SSRN: http://ssrn.com/abstract=1121198, 4), whereas others have criticized that the authors were unwilling to disclose the necessary data allowing verification of the study. See in this regard: COX and THOMAS, 'Mapping the American Shareholder Litigation Experience', 180 (ftn. 42 in particular).

[1711] *Ibid*., 37p. See on the findings of this report also: EVANS, 'Investor Compensation Fund', 230 ff. asserting that the results do not make away with the compensatory purpose of securities class actions as such. Criticizing the study for being imprecise in its calculations and other comments: EVANS, 'Are Investors' Gains and Losses', 52p. The Thakor study also received attention in US national media, see for instance: K. LEHN, Private insecurities, *Wall Street Journal*, 2006, 15 February; J.D. GLATER, Critics of Shareholder Suits Aim at Big Holders, *The New York Times*, 2005, October 27.

[1712] 'Large, diversified institutional investors' are those investors filing a 13F-form with the SEC. Section 13F of the Securities Exchange Act of 1934 requires all institutional investment managers exercising investment discretion over $100 million or more to report their holdings to the SEC on a quarterly basis. THAKOR, NIELSEN and GULLEY, 'The Economic Reality', 8, ftn. 16.

yet losses may and will still occur and fail to net out on the individual level.[1713] Moreover, even some large, diversified investors were shown to suffer losses regardless of their diversification levels, which seems to undermine the argument that circularity occurs on a broad scale between diversified investors.[1714] As a result, the circularity discussion, and by extension the merits of the US investor litigation system from a compensatory perspective, has remained subject of intense debate in the US.[1715]

506. Assessment: the circularity concern from a European perspective? – Based on the preceding paragraphs, it can be concluded that circularity occurs when compensation for misrepresentation related-harm is paid out by issuers to shareholders who have retained their shares, as these shareholders are both on the paying side and the receiving end, yet overall, these shareholders lose on the transaction as it comes at considerable costs (such as lawyers' fees, expert commissions, and other legal costs). Assessing the potential occurrence and impact of circularity in European Member States in comparison with the US, it should be noted, however, that some particular US civil procedural aspects are likely to reinforce circularity. For instance, circularity only occurs when issuers – and thus shareholders – are being held liable for the loss, which is more or less invariably the case in the US Rule 10-b5 setting. More particularly, even though directors and officers also may be held liable according to US law, these parties generally do not contribute to the settlement in US law practice (see extensively below). Moreover, according to longstanding US case law claims against so-called 'secondary actors' (being aiders and abettors) who contributed, facilitated or participated in a scheme to defraud investors have been consistently barred under Rule 10b-5, which causes investors to direct their claims against the issuer.[1716] Other than the US Supreme Court, however, European Member States do not prohibit liability claims to third parties contributing to misreporting and therefore allow for (more) spreading of the loss over all parties involved, thereby reducing the circular effect.[1717] Second, it has been repeatedly stated in the US scholarly literature that lawyers' fees in

[1713] See in this regard also: EVANS, 'Are Investors' Gains and Losses', 4.

[1714] DE JONG, *Schade door misleiding*, 373.

[1715] COX and THOMAS countered the circularity critique arguing that the phenomenon of self-suing shareholders is not a unique characteristic of securities class litigation but a common feature of any lawsuit between companies owned by diversified shareholders. (COX and THOMAS, 'Mapping the American Shareholder Litigation Experience', 164) Hence, it follows from this finding that the criticism directed at the socially wasteful wealth transfer between groups of shareholders in the context of securities class actions equally applies to every situation in which diversified shareholders sue. ROSE and SQUIRE pursue the topic further, arguing that 'intraportfolio litigation' may serve portfolio governance purposes in terms of aligning managerial and shareholder interest. See: ROSE and SQUIRE, 'Intraportfolio litigation', 1679. The authors assert however that whereas their rationale may explain why shareholders engage in self-suing lawsuits in general, the rationale fails with regard to securities class actions (p. 1699-1703 in particular). Others questioning the circularity criticism: J.J. PARK, 'Shareholder compensation as a dividend', 108 *Mich. L. Rev.*, 2009, 323. See also: FISCH, 'Confronting the Circularity Problem in Private Securities Litigation', 333.

[1716] See in this regard for instance: Stoneridge Investment Partners v. Scientific-Atlanta, 552 US 148 (2008). The reason underlying this ban relates to policy considerations (and the floodgate argument once again) as the Supreme Court held in *Stoneridge* that it was not willing to expose a "new class of defendants" to the litigations risk of Rule 10b-5. The court underlined that parties contracting with US issuing companies may "find it necessary to protect against these threats, raising the costs of doing business" while 'overseas firms with no other exposure to our securities laws could be deterred from doing business" with US listed firms. As the court considered that "this may raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets", the court refused to lift the ban. Stoneridge Investment Partners v. Scientific-Atlanta, 552 US 148 (2008), at 163-164. See also: WANEKA, 'Stoneridge Investment Partners v. Scientific-Atlanta', 303; BLACK, 'Stoneridge Investment Partners', 17p.

[1717] The recent *Gaudriot*-decision by the French Court of Cassation even facilitated future investor claims initiated against directors and executives who have engaged in securities fraud. Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (SA EPF Partners/A.), *La Semaine Juridique Entreprise et Affaires*, 2010, n° 20, Mai, 1483, with annotation by S. SCHILLER. French courts originally upheld the rule that directors could not be liable vis-à-vis third parties such as shareholders as long as they had acted within the course of their duty. Only to the extent behavior incompatible with the normal performance of duties was established, board members could be held personally liable ("*faute séparable*"). A legislative initiative aimed at securities class actions measure up to considerable costs, which increases the transaction costs one may incur in the US civil litigation system and the cost of these circular wealth transfers in general.

Despite this different context however, there is reason for concern in Europe too, especially as various EU Member States have promulgated statutory liability regimes for secondary market misinformation that provide for specific and tailored causes of action, yet only when filed against the issuer while excluding any other potential culprit from being sued under these statutory regimes.[1718] Although alternative causes of action (based on general liability law) may still be available against non-issuer defendants, such as directors, executives and experts or accountants, these claims will often be harder to bring since no tailored and specific adjustments or facilitations will apply, as is the case with certain statutory regimes. Moreover, even without the express exclusion in statutory rules of defendants other than the issuer, the latter is generally likely to be the first choice defendant because of its deep pockets anyway.

507. Finally, when assessing the effect of circularity on the effectiveness of liability rules, it should also be taken into account that rejecting the availability of compensation for misrepresentation related-harm for the mere reason of circularity also brings costs about. Investors trading on financial markets trust that the laws prescribing correct and timely disclosures are being complied with and that they are not cheated or misled as a result. To the extent the market or pricing system can be corrupted through violations of the laws without means available to individual investors to obtain compensation for the resulting loss, investors will demand a higher price in terms of risk premium to cover for the risk of being misled. It was noted in the outset of this chapter already that this will increase the costs of trading and affect liquidity.[1719]

2. Limited compensation

508. Limited compensation. – Recovery has traditionally been one of the principal motivations underlying civil liability as it aims to provide relief to the victim of wrongfully inflicted harm. However, damages for misstatements according to Rule 10b-5 have been found to cover only a fraction of the loss suffered. More particularly, on average aggregate damages obtained by US investors measured against the total decline in value upon market realization of the fraud amount to less than 10 percent.[1720] Prior to drawing any conclusions based on these numbers, we would like to

eliminating the rule by an express statutory rule submitted in 2003 was rejected in parliament. Courts began gradually reducing the rule's impact, starting with judgments holding that intentional wrongdoing was incompatible with the execution of directors' duties. In its *Gaudriot*-decision of 2010, the Supreme Court held that personal losses suffered by shareholders can be recovered from board members and the CEO if the loss was incurred as a result of their tortuous behavior, while it is not required that the tortuous behavior was intentional or of a particular serious nature. See also SPITZ, *La réparation*, 195 ff.; ARONS, *Cross-border Enforcement*, 112 ff.

[1718] See for instance with regard to the UK: DAVIES and WORTHINGTON, *Gower and Davies' Principles*, 962, noting that only the issuer can be held liable for false statements or dishonest delay is "[a] striking feature" of the statutory regime. See in this regard also the German liability regime for misleading or wrongfully omitted ad hoc disclosures, contained in §§37b, c WpHG, which also allows for claims against the issuer, while excluding other potential defendants from its scope.

[1719] *Supra*, para. 392 and references cited.

[1720] COFFEE, 'Reforming Securities Class Action', 1545; BURCH, 'Reassessing damages', 372; ALEXANDER, 'Rethinking Damages', 1500. These authors (as well as others) have supported their findings on reports published by NERA Consulting. These publications report on the ratio of settlement to investor loss, though for the sake of clarity and completeness, it should be noted that the term 'investor loss' as used in the NERA-reports is a proxy for the aggregate amount that investors lost from buying the defendants' stock rather than investing in the broader market during the alleged class period, measured according to the performance of the S&P 500. As such, *any* stock that underperforms the S&P 500 may result in an investor loss in this sense. The proxy also represents a rough measure of the 'size' of the case. The size of the potential claim has in turn been found a strong predictor for settlement outcome. R. COMOLLI, S. KLEIN, R.I. MILLER and S. STARYKH, Recent Trends in examine the various reasons that have been advanced explaining how these (relatively low) amounts of damages are determined and why investors have accepted these damages, especially since these compensations are generally obtained through settlements. Some of the reasons appear to be embedded in the US procedural legal system, such as the vexed matter of plaintiff attorney compensation in the US class action system[1721], while others may result from circumstances less exclusively confined to the US system. For example, examined into closer detail, it appears that settlement and insurance practices are particularly influential with regard to the amount of damages.[1722]

a. Interplay between damages, settlements and insurance coverage.

509. Settlement practice. – It was noted earlier already that securities class actions are generally settled, rather than being adjudicated in court.[1723] One of the reasons why parties prefer settlement over court judgment most likely relates to the uncertainties surrounding US securities fraud trials[1724] and the high costs litigation brings along, e.g. the costs related to discovery, lawyers, experts etc.[1725] Hence,

Securities Class Action Litigation: 2012 Full-Year Review, 2013, available at http://www.nera.com/p. 7 and p. 32. The report for 2012 shows that the larger the case in terms of the size of investors' potential claims, the lower the ratio gets. For instance, claims with a size of less than $20 million result in settlements of 17 percent of the investor loss. Cases exceeding $1 billion only deliver a settlement for 0.7 percent of the investor loss. The 2011 report shows similar findings, though with higher ratios: investor losses below $20 million on average settle for 39 percent of investor losses, while cases with investor losses over $1 billion settle for an average of 2 percent of investor losses. See for more details: J. MILEV, R. PATTON, S. STARYKH and J. MONTGOMERY, Recent trends in Securities Class Action Litigation: 2011 Year-End Review, 2011, available at www.nera.comp. 28. The report offering insights on securities litigation in 2010 provides an overview of the evolution of the ratio from 1996 to 2010. According to the graphs, the ratio measuring settlement to investor losses declined from 7 percent in 1996 to 2.6 percent in 2002 and has fluctuated with an upper limit of 3.1 percent (2005) and a lower limit of 2.2 percent (2004 and 2006) for the following years to 2010. See: J. MILEV, R. PATTON and S. STARYKH, Trends 2010 Year-End Update: Securities Class Action Filings Accelerate in Second Half of 2010; Median Settlement Value at an All-Time High, 2010, available at www.nera.com, p. 25.

[1721] As plaintiff attorneys are paid according to the contingency fee-based system, they are found to often take up a considerable part of the compensation awarded in the US. Fees around 30 percent of the settlement amount are considered custom for instance. See on this topic also: COFFEE, 'Reforming Securities Class Action', 1546; LANGEVOORT, 'Capping Damages', 650, noting that attorneys' fees begin at around twenty percent of the amount of recovery, and noting that 20 percent to 35 percent is typical.

[1722] An encompassing and exhaustive in-depth analysis of what exactly drives settlement agreements is however out of place in this context, instead the following references can be consulted in this regard: BAKER and GRIFFITH, 'How the merits matter', 755; T. BAKER and S.J. GRIFFITH, *Ensuring corporate misconduct: how liability insurance undermines shareholder litigation*, London, Chicago, The University of Chicago Press, 2011, 152.

[1723] See in this regard for instance: COMOLLI, KLEIN, MILLER and STARYKH, Recent Trends in Securities Class Action Litigation: 2012 Full-Year Review, p. 23 showing the proportion of resolved cases that got settled v. dismissed. None of the cases resolved in 2012 (153 cases in total according to the report) reached verdict, 93 cases out of 153 (or 61 percent) reached settlement while the remainder (60 cases or 39 percent) was dismissed. Another report shows that of the 236 cases filed in 2000, 149 or two thirds (63 percent) were settled, while the rest (87 cases or 37 percent) was dismissed. According to the report four of the cases filed in 2000 proceeded to trial though were also settled in the end and included in the settlement numbers as a result. See for more details: MILEV, PATTON, STARYKH and MONTGOMERY, Recent trends in Securities Class Action Litigation: 2011 Year-End Review, 12. Similar reports for previous years are available. See also: KLAUSNER and HEGLAND, 'When are securities class actions dismissed', showing that 61 percent of the securities class actions filed between 2000 and 2003 ended up settled between 2001 and 2009, whereas 5 percent was still ongoing and 34 percent had been dropped of dismissed. In an adjacent publication showing statistics for claims filed between 2006 and 2010 39 percent of the claims had been settled, while 43 percent had been dropped or dismissed (18 percent was still ongoing. See: M. KLAUSNER, J. HEGLAND and M. GOFORTH, 'When Are Securities Class Actions Dismissed, When Do They Settle, and For How Much? An Update', vol. XXVI *Plus*, 2013, nr. 4 (also available at SSRN: http://ssrn.com/abstract=2260831). See also: LANGEVOORT, 'Capping Damages', 648; J.C. ALEXANDER, 'Do the merits matter? A study of settlements in securities class actions', 43 *Stan. L. Rev.*, 1991, no. 3, 524; BAKER and GRIFFITH, 'How the merits matter', 768 ("Trials are exceedingly rare in securities class actions, and adjudicated outcomes after the motion to dismiss are almost unheard of").

[1724] For one thing the concept of recoverable loss and issues involving the measurement of damages is (yet) an unsettled matter in the US courts, as already pointed out. Extensively in this regard: BAKER and GRIFFITH, 'How the merits matter', 755.

[1725] Extensively in this regard: *Ibid*.,755.

the uncertainty about the outcome of trial coupled with the certainty that significant costs will be incurred provides all parties with incentives to choose settlement over trial. The fact that these cases are rather being settled than adjudicated by courts is also relevant with regard to Directors and Officers insurance, or D&O-insurance as these liability insurance policies for corporate officials are generally coined. The mechanism of D&O insurance, its relation with settlements and the amount of compensation is discussed in the text below.

510. D&O-insurance. – More or less all US public corporations have been found to provide insurance coverage for their corporate officials for liability-related costs arising in the course of their duties.[1726] These costs include expenses following litigation initiated against insured corporate officials, such as costs of hiring counsel and damages that may flow from liability claims adjudicated in court.[1727] From the perspective of companies, D&O-insurance enables their executives to take acceptable risks without having to fear financial consequences of claims initiated against them following their actions and decisions as regards the company. Without such protection, they fear that managers may act overcautiously and avoid (reasonable) risks in carrying out their duties out of fear of being held responsible with personal assets.[1728] D&O-insurance is customarily also considered vital to attract the most capable and competent managers, who require such protection.[1729] D&O-insurance has not only proven successful in the US, but has also increasingly gained ground in the EU over time.[1730] D&O-insurance, in the US and in the EU generally consists of three clauses, including coverage for indemnification of individual corporate agents (Side-A coverage), coverage for the corporate entity in case it has to indemnify corporate agents (Side-B coverage) and coverage for indemnification of the

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[1726] BAKER and GRIFFITH, 'How the merits matter', 760-761, with reference to a report published by the Tillinghast business of Towers Perrin (TOWERS PERRIN, Directors and Officers Liability, 2006 Survey of insurance purchasing and claims trends). Towers Perrin was a professional services firm which merged in 2010 with Wyatt Watson into Towers Watson. The reports are available at: http://www.towerswatson.com. See also: COFFEE, 'Reforming Securities Class Action', 1546.

[1727] For an extensive overview of D&O-insurance practices, consult the extensive research on the topic by BAKER and GRIFFITH, *Ensuring corporate misconduct*, 42 ff. The authors have also published on the topic: T. BAKER and S.J. GRIFFITH, 'Uncovering a gatekeeper: Why the SEC should mandate disclosure of details concerning directors' and officers' liability insurance policies', 154 *U. Pa. L. Rev.*, 2006, 1147; and: BAKER and GRIFFITH, 'How the merits matter', 755; T. BAKER and S.J. GRIFFITH, 'The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer', 95 *Geo. L.J.*, 2007, 1795; see also: M.H. BAER, 'Insuring corporate crime', 83 *Ind. L.J.*, 2008, 1035.

[1728] T. TALAULICAR, 'D&O Deductibles as a New Standard of Responsible Governance', I. PIES and P. KOSLOWSKI, *Corporate Citizenship and New Governance*, Heidelberg, New York, Springer, 2011, 147-148; EASTERBROOK and FISCHEL, 'Optimal damages', 641; BAKER and GRIFFITH, *Ensuring corporate misconduct*, 221; HELLGARDT, *Kapitalmarktdeliktsrecht*, 393; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 71; W.C.T. WETERINGS, Possible Conflicts of Interest with D&O Insurance in Event of Shareholders' Class Actions, 2013, August, available at SSRN: http://ssrn.com/abstract=2308553, 5.

[1729] GERNER-BEUERLE, PAECH and SCHUSTER, Study on Directors' Duties and Liability, 184.

[1730] D&O-insurance is available in all Member States: *Ibid*., 172. For the increasing importance of D&O-insurance in Belgium, see for instance: C. COUNE and D. HUBIN, 'Aansprakelijkheid van bedrijfsleiders en verzekering', 2 *Bull. Ass.* 2012, n° 379, 181; N. GLIBERT, 'De verzekering van bestuurdersaansprakelijkheid', *R.G.D.A.* 2010, af. 8, nr. 14670; K. DELESIE and N. GLIBERT, 'Bestuurders wees op uw hoede, laat uw verzekeraar niet in het ongewisse', in C. VAN SCHOUWBROECK, W. DEVROE, K. GEENS, J. STUYCK and H. COUSY (eds.), *Over grenzen: Liber Amicorum Herman Cousy*, Antwerpen, Intersentia, 2011, 439; C. COUNE and T. LOFFET, 'De verzekering van de aansprakelijkheid van bedrijfsleiders in de praktijk', *TBH* 2011, afl. 2, 99; J.-F. GOFFIN, *Responsabilités des dirigeants de sociétés*, Bruxelles, Larcier, 2012, 352, para. 232-242. Similar: on the increasing use of D&O-insurance in the Netherlands: W.C.T. Weterings, 'Bestuurdersaansprakelijkheid, D&O-verzekering en moreel risico: hanteren van eigen risico bij Side A-dekking is wenselijk', *Ondernemingsrecht*, 2011, nr. 16, 571; and W.C.T. WETERINGS, 'De aansprakelijkheidsverzekering voor bestuurders en commissarissen in de (verzekerings)praktijk', *Het Verzekerings-Archief* 2010, nr. 4, 161; WETERINGS, 'Possible Conflicts of Interest with D&O Insurance', 19p. Germany: R. KOCH, 'Einführung eines obligatorischen Selbstbehalts in der D&O-Versicherung durch das VorstAG', *AG* 2009, heft 18, 637; C. OLBRICH, *Die D&O-Versicherung*, Karlsruhe, VVW, 2007, 5 ff.; and an earlier publication reporting an increasing trend: P.S. RYAN, 'Understanding Director & Officer Liability in Germany for Dissemination of False Information: Perspectives from an Outsider', 4 *German Law Journal* 2003, No. 5, available at: SSRN: http://ssrn.com/abstract=450640, 439. UK: legislative changes in 1989 and 2004 have facilitated D&O-insurance in the UK. See in this regard: DAVIES, 'Liability for misstatements', 305.

company itself in case claims are being filed against it (Side-C coverage). The developments with regard to D&O-insurance have affected securities fraud litigation as it contributes to the incentives to settle on the one hand, and affects the determination of investor compensation as well. Both of these 'side-effects' of D&O-insurance are explained into more detail in the following paragraphs.

511. Interaction between settlements and insurance practices. – It has become customary in US securities class actions to sue both the issuer of the securities and the corporate officials who are allegedly responsible for the misstatements. Whereas issuers generally have the deepest pockets, executives are often sued to trigger their D&O-insurance and have the insurer contribute to the settlement fund.[1731] Interestingly, insurance law or policies (in the US and elsewhere) customarily exclude indemnifications for deliberate misbehavior such as fraudulent, criminal or dishonest misconduct.[1732] However, even though Rule 10b-5 comprises the requirement of 'scienter', which means that the defendant must have had a certain awareness of committing fraud by the issuance of the deficient disclosure, it has been reported that the 'fraud exclusion' generally does not preclude the coverage from being triggered in the US. [1733] One reason why insurers do not invoke the fraud-exclusion relates to the different standards of what constitutes fraudulent behavior in securities fraud

[1731] ALEXANDER, 'Do the merits matter', 530. See also: M. KLAUSNER, J. HEGLAND and M. GOFORTH, 'How Protective is D&O Insurance in Securities Class Actions?', May, 2013, holding that CEOs were named in 93 percent of securities class actions filed between 2006 and 2010 and settled between 2006 and 2012, CFOs were sued in 80 percent of the reported cases whereas outside directors were only sued in less than 39 percent of the cases.

[1732] Intentional misconduct is virtually always excluded (by statute or contract) in the EU Member States too, whereas coverage for gross negligence is often but not always excluded. See in this regard: GERNER-BEUERLE, PAECH and SCHUSTER, Study on Directors' Duties and Liability, 184. In Belgium, insurers are not obliged to reimburse for loss caused by intentional wrongful behavior by the insured. See; art. 8 of the Act of 25 June 1992 governing non-marine insurance contracts (art. 8 Wet van 25 juni 1992 op de landverzekeringsovereenkomst, *B.S.* 20 August 1992). Coverage for loss following gross negligent behavior is not automatically excluded by the statutory provisions, but the contract may contain clauses exempting the insurer from the duty to provide coverage in case of gross negligence for incidents, provided that these incidents are restrictively and expressly specified (art. 8, 2nd para). See on the application of these provisions and the concept intentional wrong in Belgium: Cass. 24 April 2009, *TBH* 2010, 56, with ann. by H. COUSY, 'Opzettelijke veroorzaking van het schadegeval: orde op zaken?', 58; Cass. 26 October 2011, *NJW* 2012, nr. 259, 214, with ann. by G. JOCQUE. See also:G. JOCQUE, 'Opzet en grove fout in rechtsvergelijkend perspectief', C. VAN SCHOUWBROECK, W. DEVROE, K. GEENS, J. STUYCK and H. COUSY, *Over grenzen: Liber Amicorum Herman Cousy*, Antwerpen, Intersentia, 2011, 151; PH. COLLE, 'Opzet en bewijs van recht op verzekeringsprestatie', C. VAN SCHOUWBROECK, W. DEVROE, K. GEENS, J. STUYCK and H. COUSY (eds.), *Over grenzen: Liber Amicorum Herman Cousy*, Antwerpen, Intersentia, 2011, 399; with regard to intentional wrongs and D&O-insurance: GOFFIN, *Responsabilités des dirigeants de sociétés*, 361, para. 238. Similarly, in France art. L 113-1 Code des assurances excluding loss following intentional or deliberate wrongs from being covered by insurance. Consult in this regard: LE TOURNEAU, *Droit de la responsabilité et des contrats*, 1062, para. 3514 and references cited; see specifically with regard to its application in the context of D&O-insurance (*Marionnaud*): Cass. (2nd Civ.) 14 June 2012, n° 11-17.367, *Rev. Soc.* 2012, 637, with ann. by L. GRYNBAUM, in which the French Supreme Court confirmed that the administrative fine imposed by the market supervisor following deliberate misrepresentations of financial information by a director with the intention to deceive the public and inflate the stock price, could not be recovered from the insurer via D&O coverage. While the traditional and prevailing view rejects the recovery of administrative fines through insurance in general, the court does not pass a clear judgment on the matter in general, yet instead stresses the importance of the intentional character of the wrongful behavior. See for a comment on this decision also: N. RONTCHEVSKY, *RTD Com.* 2013, 813, criticizing the traditional view and instead supporting the view that the intentional nature of the wrong should be decisive to assess the insurability of the loss suffered. Note that administrative penalties are, in principal, insurable in the US as well, provided that the wrong was not intentionally committed. Germany: §81 and §103 Versicherungsvertragsgesetz "VVG"), holding that intent ("*Vorsatz*") discharges the insurer to provide coverage. See in this regard: T. LANGHEID and M. WANDT (eds.), *Münchener Kommentar zum VVG (§§1-99)*, vol. 1, München, Beck, 2010, 1774 (with regard to §81 VVG) and T. LANGHEID and M. WANDT (eds.), *Münchener Kommentar zum VVG (§§ 100-191 VVG)*, vol. 2, München, Beck, 2011, 152 (with regard to §103 VVG). The Netherlands: art. 7:952 DCC; see for the interpretation and application of the provision: HR, 30 May 1975, *NJ* 1976, 572 (*Bierglas*). See on this decision and intentional wrong and insurance in general: M.L. HENDRIKSE, 'De opzetclausule: een nadere analyse', M.L. HENDRIKSE and J.G.J. RINKES, *De aansprakelijkheidsverzekering*, Zutphen, Uitgeverij Paris bv, 2011, 34; also: M.L. HENDRIKSE, 'Een rechtsvergelijkende analyse aangaande de verzekerbaarheid van opzet in het schadeverzekeringsrecht', C. VAN SCHOUWBROECK, W. DEVROE, K. GEENS, J. STUYCK and H. COUSY (eds.), *Over grenzen: Liber Amicorum Herman Cousy*, Antwerpen, Intersentia, 2011, 465.

[1733] Examples of cases in which D&O-insurance has not provided coverage due to fraud include Enron, Worldcom, etc.

law on the one hand, and the field of insurance law on the other.[1734] Furthermore, BAKER and GRIFFITH also observe that insurers and insured parties typically include 'final adjudication' clauses in the policies that imply that actual fraud must have been 'finally adjudicated', by means of a court decision in order for the fraud exclusion to be triggered successfully.[1735] However, since securities fraud allegations generally end up to be settled rather than being adjudicated by courts, the inclusion of final adjudication-clauses limits the potential impact of fraud exclusions substantially. Moreover, not only defendants curb the impact of the fraud exclusion, BAKER and GRIFFITH have also noted that plaintiff's lawyers strategically plead recklessness rather than fraudulent intent in order to ensure access to insurance funding and hence increase the chances to reach settlement.[1736] According to BAKER and GRIFFITH, insurers on the other hand have not intervened and invoked the fraud exclusion regardless of whether they suspect intent or rather mere recklessness because in the end, the D&O-insurance market is likely to dry up if insurers are found pressing too hard on the fraud exclusion, rendering the exclusion a mere Pyrrhic victory.[1737] As a result, corporate officials, but other parties as well, have incentives to settle rather than taking chances in court, which may result in the fraud exclusion being triggered and access to insurance funding blocked.[1738]

512. Interaction between policy limits and settlement agreement. – Since any amount exceeding the insurance policy is to be paid by the officials or the corporation, it has been found that corporate officials are inclined to try to keep the settlement within or slightly above policy limits.[1739] COFFEE notes that this tendency may even have been further exacerbated by D&O-insurance practices, since over time, D&O-insurance has developed from coverage protecting individual corporate officials against liability incurred-costs, into a more broad insurance coverage, referred to as 'corporate entity

[1734] More particularly, as pointed out earlier already, the requirement of scienter under Rule 10b-5 is met when the wrongful behavior was committed out of 'recklessness', yet no intent or willful misconduct is needed. In *Ernst & Ernst v. Hochfelder*, the Supreme Court defined 'scienter' as "a mental state embracing intent to deceive, manipulate, or defraud" (425 U.S. 185 (1976)). Mere negligence does not constitute scienter in other words, although US courts have accepted that recklessness may satisfy the requirement of scienter. See in this regard: Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977); Alpern v. Utilicorp United, Inc., 84 F.3d 1525, 1534 (8th Cir. 1996); Provenz v. Miller, 102, F.3d 1478, 1490 (9th Cir. 1996); SEC v. Steadman, 967 F.2d, 636, 641-642 (D.C. Cir. 1992). See also: VASHISTA, JOHNSON and CHOUDHURY, 'Securities fraud', (877) 885 and references cited. No uniform standard of the required recklessness exists however, as illustrated in in *Tellabs, inc. v. Makor Issues & Rights, Ltd.*: "Every Court of Appeal that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly, though the Circuits differ on the degree of recklessness required." Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 n.3 (2007) (citing Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 338, 343 (4th Cir. 2003). BAKER and GRIFFITH, *Ensuring corporate misconduct*, 186; see with regard to scienter under Rule 10b-5 also: RAPP, 'Rewiring the DNA', 11

[1735] BAKER and GRIFFITH, *Ensuring corporate misconduct*, 48-49, and 186; BAKER and GRIFFITH, 'The Missing Monitor', 1805; BAKER and GRIFFITH, 'How the merits matter', 802; FISCH, 'Confronting the Circularity Problem in Private Securities Litigation', 337.

[1736] BAKER and GRIFFITH, *Ensuring corporate misconduct*, 49, 186.

[1737] *Ibid.*, 186, 188.

[1738] COFFEE, 'Reforming Securities Class Action', 1570; BAKER and GRIFFITH, *Ensuring corporate misconduct*, 48-49, and 186. ALEXANDER on the other hand also points out that since individuals are more likely to be risk averse than corporations, they are more likely to settle in order to avoid the uncertainties they face if the case is brought to trial. ALEXANDER, 'Do the merits matter', 530. On the incentives to enter settlement on the defendant's side, consult: BAKER and GRIFFITH, *Ensuring corporate misconduct*, 153-156; BAKER and GRIFFITH, *Ensuring corporate misconduct*, 169.

[1739] BAKER and GRIFFITH, 'How the merits matter', 761, with further references (ftn. 21). Also: BAKER and GRIFFITH, *Ensuring corporate misconduct*, 61; T. BAKER and S.J. GRIFFITH, 'Predicting Corporate Governance Risk: Evidence from the Directors' and Officers' Liability Insurance Market', 74 *The University of Chicago Law Review*, 2007, 488. See also: J.D. COX, 'Making securities class actions virtuous', vol. 39 *Ariz. L. Rev.*, 1997, 497. The authors report that "approximately 96 percent of the securities class actions are within the typical insurance coverage, with the insurance proceeds often being the sole source of settlement funds." The authors note however that these findings should be compared with settlement practices in other areas, such as antitrust or medical malpractice class action settlements, in order to conclude whether or not this is a typical securities class action problem (ftn. 52).

coverage'.[1740] In addition to traditional individual protection for managers, 'corporate entity coverage' also includes coverage for the corporation, reimbursing its indemnifications obligations vis-à-vis these corporate officials and secondly, coverage for its own expenses incurred in shareholder litigation to which the corporate entity is a party. As a result of this "all inclusive" character, corporations are even more inclined to simply agree to award compensation based on the limits set out in their policies and settle the matter promptly. Prior to the emergence of corporate entity coverage on the other hand, insurers only covered for expenses made with regard to the insured executives, while corporations remained exposed and, as a result, had an interest in the outcome of settlement or court proceedings. Under corporate entity coverage on the other hand, the whole package is insured by one and the same insurer, implying that corporations can solve the dispute promptly and painlessly by simply agreeing on an amount within or proximate to the policy limits. As a result, it should not come as a surprise that the vast majority of securities claims have been found to settle within or just above the limits of the defendant corporation's coverage.

b. Limited compensation: assessment

513. Although it may be concluded that interaction between settlement processes and insurance coverage is one of the factors accounting for the relatively low amounts of damages obtained in these (US) cases, it does not explain why it is not considered more problematic by many commentators. Several explanations have been advanced in this regard, mostly drawing on policy arguments. First of all, the most frequently cited reasons supporting partial recovery relates to the fact that issuers – and hence their shareholders – do usually not reap any gain from violations against ongoing disclosure obligations.[1741] More particularly, since investor compensation in this context boils down to a group of 'innocent' shareholders paying damages to compensate for the loss to other shareholders, while parts of the group may also overlap and blur the lines between victim and defendant, the compensatory effect of damages is limited in this setting anyway.

Another often cited defense of low compensations relates to the observation that damages resulting from secondary market misstatements may build up to vast proportions, as is demonstrated in reported cases.[1742] Even though the loss sustained by an individual investor may – on balance – seem relatively small, the aggregate loss of all investors that have been trading against distorted prices over an extended period of time may show a very different picture. Requiring a corporate defendant to compensate for the total aggregate amount of loss recorded over the period during which the price was distorted may exceed the issuer's reimbursement capabilities and even jeopardize its future.[1743] For

[1740] COFFEE, 'Reforming Securities Class Action', 1570 ("Finally, with the advent of entity insurance, the corporation has much less incentive than in the past to resist the plaintiff – if it can settle within the policy's limits"). With regard to the evolution of D&O-insurance towards the so-called 'corporate entity coverage', consult: BAKER and GRIFFITH, *Ensuring corporate misconduct*, 42 ff.

[1741] EASTERBROOK and FISCHEL, 'Optimal damages', 641; also: LANGEVOORT, 'Capping Damages', 646; DAVIES, 'Liability for misstatements', 300; COFFEE, 'Reforming Securities Class Action', 1556; BLACK, 'Should the SEC', 322.

[1742] COFFEE presents a list of mediatized corporate scandals in which damages ware awarded ranging from \$8.100.000 to \$6.156.100.000 (COFFEE, 'Reforming Securities Class Action', 1543). Other sources offering indications on the size of these claims are found in reports presented by NERA for instance, stating that the median value for settled cases amounted to \$11.1 million in 2010.

[1743] SPITZ, *La réparation*, 83; LANGEVOORT, 'Capping Damages', 639. It is noted however that at this point, the size of damages awarded in US securities class actions generally outweighs the amounts awarded in European countries by far. Comparing reported damages awarded by French courts clearly demonstrates the different proportions. An overview of damages awarded by French courts in recent cases is presented by SPITZ, *La réparation*, 199. Damages here are considerably lower and range from € 762 to € 5.300.000. The overview presented by COFFEE in one of the previous footnotes showed ranges from \$8.100.000 to \$6.156.100.000, although it is noted that these figures represent the largest and most mediatized instance, considering the costs these claims may bring along for issuing companies, recent Canadian reforms that introduced statutory liability rules that apply to secondary market civil liability claims provide in capped damages for the investors, motivated by concerns on the viability of the system.[1744]

514. A final consideration on the relatively low amount of compensation of US securities fraud claims relates to the finding that notwithstanding the criticism that the US system falls short of providing real and adequate compensation for violations, European investors have repeatedly been found to seek damages in US courts, rather than filing claim in their home countries.[1745] Although compensation for misleading statements to secondary markets is limited to a fraction of the claimed loss in the US, it seems nonetheless still worthwhile and preferable over the expected outcome in the home jurisdictions for these European investors.[1746]

515. Conclusion. – Although compensation is thus limited to a fraction of the loss, it does not appear an insurmountable problem when considered in a broader (policy) perspective, including the implications of such liability for issuers and their shareholders. This is however not to say that violations of mandatory disclosure rules cause no harm at all or that recovery is misplaced. Violations of the disclosure obligations affect the overall confidence investors place on credibility of the disseminated information. To the extent investors would be denied compensation for the harm suffered as a result of wrongful misrepresentations, they are exposed to an uncompensated risk.[1747] Aware of the risk of being cheated, investors may either refuse to invest or try to cover the risk by investing in finding more information, conducting more research and testing the reliability and credibility of information they find. As with all other risk attached to investments, investors will demand a higher

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cases, involving firms with large market capitalization. Another illustration of the size of damages in the US is for instance the median value of damages determined in settlements amounting to $11.1 million in 2010 and $12 million in 2012, as reported by NERA (both numbers were record numbers compared to previous years). It is also noted that myriad factors may explain the difference in proportion, for one thing average market capitalization is significantly higher in the US than in France. Furthermore, it is repeated that the calculation of damages by French courts has recurrently involved a lump sum-approach without much clarification as to how exactly the damages were determined. As a result, these numbers are meant as mere illustrations of the vast differences in terms of damages in both jurisdictions. See on these numbers: COFFEE, 'Reforming Securities Class Action', 1543; MILEV, PATTON and STARYKH, Trends 2010 Year-End Update: Securities Class Action Filings Accelerate in Second Half of 2010; Median Settlement Value at an All-Time High, 2; COMOLLI, KLEIN, MILLER and STARYKH, Recent Trends in Securities Class Action Litigation: 2012 Full-Year Review, 28.

[1744] For example, Ontario and Quebec law provide for a statutory regime applicable to secondary market civil liability claims that caps damages: S.138.1-s.138.14 Ontario Securities Act (enacted in 2005) provides for a damages cap limiting damages to the greater of $1 million or 5 percent of its market capitalization (the term “market capitalization” is defined in the regulations). The Ontario model has led the way as similar statutory regimes were adopted in other Canadian provinces, drawing on the Ontario model. See for instance the Quebec Bill 19, An Act to Amend the Securities Act and Other Legislative Provisions, 2007, available at http://www2.publicationsduquebec.gouv.qc.ca, which provides an identical damages cap applicable to issuer liability for secondary market misstatements. See on these regimes also: P. PURI, 'Securities Litigation and Enforcement: The Canadian Perspective', 37 *Brook. J. Int'l L.*, 2012, No. 3, 867, see particularly p. 999 ff.; FERRAN, 'US-style investor suits', 330 (with regard to the Ontario law); A. LAING and R. CARSON, 'Whither common law claims for secondary market misrepresentation?: an analysis of certification decisions in McCann v. CP Ships, Silver v. IMAX, McKenna v. Gammon Gold, and Dobbie v. Arctic Glacier', 7 *The Canadian Class Action Review* 2011, no. 1, 103 (discussing Ontario law); R. CARELLI, 'Canada: prospectuses - secondary market', 23 *JIBLR* 2008, iss. 7, 62 (with regard to the Quebec law). In line with the considerations underlying the introduction of statutory regime in Canada, commentators in European jurisdictions also have argued in favor of the installment of capped damages for issuer liability. See for instance: SPITZ, *La réparation*, 83, paras. 122-123; DE JONG, *Schade door misleiding*, 229.

[1745] At least prior to the US Supreme Court decision in *Morrison.* See *supra*, para. 413 and ftn. 1708.

[1746] H. DE WULF, 'Aandeelhoudersvorderingen met het oog op schadevergoeding, of waarom elke aandeelhouder vergoeding van reflexschade kan vorderen, België class actions moet invoeren en de minderheidsvordering moet hervormen', X., *10 jaar wetboek vennootschappen in werking - 10 ans d'entrée en vigueur du code des sociétés*, Mechelen, Wolters Kluwer Belgium, 2011, 514-515.

[1747] EASTERBROOK and FISCHEL, 'Optimal damages', 641; also: LANGEVOORT, ‘Capping Damages', 646; DAVIES, 'Liability for misstatements', 300.

price in terms of risk premium to cover for the risk of being deceived. On the issuers' side, efforts will be made to signal the reliability and credibility of the firm in order to attract investors and limit the transaction costs as much as possible. Overall, the result is that valuable resources are being spent on additional (and replicate) research and analysis instead of being made available for investments. The cost of capital will increase, or put differently, an allocative efficiency loss is likely to emerge, as it is termed in the law and economics literature.[1748]

Secondly, it is repeated that some explanations for the lower amounts of compensation may also relate to particular US civil procedural aspects, such as the aforementioned role and compensation of plaintiff-attorneys. More particularly, US plaintiff attorneys conducting securities class actions are usually paid according to the contingency fee-based system. It is a longstanding observation that plaintiff attorneys take up a considerable part of the compensation awarded, at the expense of the actual claimants. [1749] Since EU Member States and the Commission have shown restraint to introduce 'foreign' legal concepts and rules in the context of collective redress mechanisms, and instead have expressed a distinct preference for a private enforcement system that draws on European legal concepts and rules, this kind of claims might operate in a different fashion on this side of the Atlantic, with different implications as to the amount of compensation.[1750]

That being said, it is noted that the criticism and observations with regard to limited recovery often relate to the fact that *issuers* are being held liable for the loss incurred following misleading statements to the market.[1751] To the extent that not issuers, but other entities or individuals – experts such as auditors, corporate officials etc. – have wrongfully inflicted harm, or contributed, aided or abetted in the wrong and consequently held liable for their part in the loss, several of these criticisms (e.g. circularity and unfairness) may be mitigated. As explained earlier already, however, the issuer is almost invariably at the center of securities fraud class actions, partly because the US Supreme Court has consistently barred claims against 'secondary' actors, aiding and abetting in the commission of the wrong in the context of Rule 10b-5[1752], yet also because managerial liability is oftentimes also successfully shifted to the issuers, which may pose a far more fundamental problem to the effectiveness of the system, as discussed below.

B. Deterrence

516. Conceding that private securities litigation does not adequately fulfill its compensatory goal in the US issuer centered-liability system, several proponents of issuer liability under Rule 10b-5 have nevertheless continued to support the system from the angle of deterrence, asserting that the threat of civil liability discourages future wrongdoers from engaging in harmful behavior.[1753] More recently however, this justification has become considered flawed too. One problem relates to the observation

[1748] EASTERBROOK and FISCHEL, 'Optimal damages', 639. Similarly asserting that fraud is not a risk that should be imposed on the investors as this would result in deadweight losses, being increased transactions costs, both on the side of the investors and the issuers: EVANS, 'Investor Compensation Fund', 228; SPITZ, *La réparation*, 78, para. 112.

[1749] In US securities class actions it is custom that plaintiff attorneys are paid around 30 percent of the settlement amount. See for instance: COFFEE, 'Reforming Securities Class Action', 1546; LANGEVOORT, 'Capping Damages', 650 noting that attorneys' fees begin at around twenty percent of the amount of recovery, and noting that 20 percent to 35 percent is typical.

[1750] See *supra*: para. 495ff. with regard to national and EU initiatives to establish collective redress systems.

[1751] Stoneridge Investment Partners v. Scientific-Atlanta, 552 US 148 (2008).

[1752] Stoneridge Investment Partners v. Scientific-Atlanta, 552 US 148 (2008).

[1753] COFFEE, 'Reforming Securities Class Action', 1549; ROSE and SQUIRE, 'Intraportfolio litigation', 1687; ALEXANDER, 'Rethinking Damages', 1499; BRATTON and WACHTER, 'Political Economy', 69; LANGEVOORT, 'Capping Damages', 639.

that companies with considerable market capitalization are far more likely to be sued on the basis of Rule 10b-5 than companies with relatively small market capitalization.[1754] This finding was explained as a side effect of the profit driven nature of securities litigation in the US.[1755] More particularly, as market capitalization is related to the size of potential damages, while the size of damages in turn determines the attorneys' fee, this strand of literature asserted that plaintiff attorneys tend to single out defendants with considerable market capitalization only, allowing perpetrators with 'small' market capitalization to slip through the net. As a result, private securities law enforcement is argued to be fragmented and lack deterrent effect vis-à-vis smaller players who are systematically left out for being unprofitable.[1756] Over time however, some of the research has been criticized for methodological flaws, impugning some of the conclusions reached.[1757]

517. The major obstacle to the deterrent objective of private securities litigation however relates to the mechanisms and impact of D&O-insurance. As mentioned earlier already, D&O-insurance has become customary in US listed firms and has been on the rise in Europe as well. It was also pointed out that one of the corollaries of the widespread use of D&O- and corporate entity insurance seems to be that securities litigation costs and damages are (either directly or indirectly through insurance premiums) borne by the issuer and virtually never attributed to or recovered from corporate officials.[1758] Yet it is the latter group of individuals that should be discouraged to disclose overly optimistic information since they are often the primary and direct beneficiaries of inflated stock

[1754] This assertion was advanced in the context of research indicating that the merits of a claim do not matter (much) with regard to settlement outcomes. A seminal contribution in this regard was published by Prof. ALEXANDER and indicated that rather than merits, market capitalization and the potential damages (in aggregate) were more relevant, regardless of whether the case actually had merit. ALEXANDER, 'Do the merits matter', 500 ff. See in this regard also: ROSE, 'Reforming Securities Litigation Reform', 1304; COFFEE, 'Reforming Securities Class Action', 1543.

[1755] On the profit driven nature of securities class actions, Alexander particularly held that "[the results] strongly suggest that suits alleging securities violations were filed whenever the stock price declined sufficiently following the IPO *to support an award of attorneys' fees that would make it worthwhile to bring a case*" (*emphasis added*); and "Plaintiffs' lawyers' descriptions of their methods of locating potential securities class actions also support the inference that suits were filed whenever there was a sudden decrease in the stock price that produced a market loss sufficient to support the necessary fee." ALEXANDER, 'Do the merits matter', 513. The role of the plaintiff attorney as an entrepreneur picking the cases he prefers to pursue is an established and long accepted concept in the US litigation landscape: COFFEE, 'Understanding the Plaintiff's Attorney', 669. See also: ROSE, 'Reforming Securities Litigation Reform', 1304; COFFEE, 'Reforming Securities Class Action', 1543; ALEXANDER, 'Do the merits matter', 511 ff.; V. WINSHIP, 'Fair Funds and the SEC's Compensation of Injured Investors', 60 *Fla. L. Rev.*, 2008, 1108: "The archetypal private attorney general in the securities area is a profit-seeking counsel who brings a class action with the purpose of earning fees […]"

[1756] It has been asserted that following the PSLRA, the fragmentation has even increased since the legislation has raised the costs further and therefore increased the threshold for issuer litigation risk. See in this regard: J.A. GRUNDFEST and M.A. PERINO, 'Securities Litigation Reform: The First Year's Experience a Statistical and Legal Analysis of Class Action Securities Fraud Litigation Under the Private Securities Litigation Reform Act of 1995', 1997, available at SSRN: http://ssrn.com/abstract=10582. And: COFFEE, 'Reforming Securities Class Action', 1544.

[1757] BAKER and GRIFFITH, 'Uncovering a gatekeeper', 1158 ff.; COX, 'Making securities class actions virtuous', 503.

[1758] COFFEE, 'Reforming Securities Class Action', 1550; ROSE and SQUIRE, 'Intraportfolio litigation', 1687; ALEXANDER, 'Rethinking Damages', 1499; KLAUSNER, HEGLAND and GOFORTH, 'How Protective is D&O Insurance in Securities Class Actions?', noting that although CEOs and CFOs are frequently named as defendant, they only rarely to the payment of damages. Examination of securities class actions filed between 2006 and 2010 and settled between 2006 and 2012 learned that whereas CEOs were named in 93 percent and CFO's in 80 percent of the cases, these officers contributed to the settlement fund only in to 2 percent of the cases. Claims against outside directors (sued in less than 39 percent of the cases) had not resulted in any contribution yet, although the authors pointed out that 18 percent was still ongoing and may change that figure. Overall, executive contribution to settlements is conspicuously low as a result of the combination of D&O-insurance coverage, settlement practices and issuers picking up the check. With the exception of the (relatively low) deductibles that rarely apply with regard to Side A D&O-insurance policies, corporate officials generally do not pay the damages following suit or settlement. See with regard to the inclusion of retentions/deductibles in D&O-insurance policies: BAKER and GRIFFITH, 'Uncovering a gatekeeper', ftn. 59 in particular, and further below in this text: *infra* para. 529.

prices.[1759] For instance, ARLEN and CARNEY have shown a correlation between poor firm performance and the occurrence of wrongdoing, which has been explained by pressured executives tempted to delay the disclosure of the firm's underperformance or other distressing news out of self-interest. Executives may for example be motivated to misrepresent the situation out of fear of losing reputation and/or their job (through dismissal or hostile takeover for instance), or may be motivated by personal financial gain.[1760] As their compensation packages often include financial bonuses linked to the stock performance, stock options and other perks and compensation based on equity evolutions, it is corporate insiders rather than issuers who actually benefit from inflated stock prices.[1761] [1762]Although corporate officials clearly suffer reputational losses and – in serious cases – may even incur criminal charges, on average, however, the consequences of misconduct that give rise to D&O-claims are limited to damages resulting from shareholder litigation. As damages and litigation expenses incurred by executives and officers are routed back to insurers and issuers via the aforementioned insurance mechanisms, the consequences of corporate misconduct are often rather limited for corporate officials.[1763] It is also worth noting in this regard that research has suggested that unlike the fraud exclusion (stating that in case of fraud insurers are relieved of their obligation to indemnify), unjust enrichment-exclusions were found effective and do bar indemnification in case individuals have acquired benefits to which they were not entitled.[1764] The moral hazard concern raised by D&O-

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[1759] See for instance the poster child of corporate fraud, Enron, in which accounting fraud had inflated Enron-stocks for a considerable period during which executives involved in the fraudulent set ups, had sold their options and unjustly enriched their selves. The former chairman for instance was reported to have received $20.7 million exercising options in 2001, a few months before the collapse, and more than $180 million during the three years prior to the bankruptcy. See for a detailed report on the Enron-fraud by the Enron Board investigating the causes of the Enron bankruptcy after its collapse: Report of Investigation, by the Special Investigative Committee of the Board of Directors of Enron, Corp., W. C. POWERS (chair), R.S. TROUBH, H.S. WINOKUR. See also: J. ARMOUR and J.A. MCCAHERY, 'Introduction: After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US', J. ARMOUR and J.A. MCCAHERY, *After Enron: Improving Corporate Law And Modernising Securities Regulation in Europe And the US*, Portland, Hart Publishing, 2006, 1 ff. See in this regard also the SEC complaint relating to the accounting fraud case against Fanny Mae. The SEC particularly declared that the fraud, consisting of financial results that had been misrepresented, had been carried out to maximize the performance-based executive compensation. See in this regard: SEC v. Fed. Nat'l Mortgage Ass'n, n° 1:06CV00959, http://www.sec.gov/litigation/complaints/2006/comp19710.pdf, para. 1-2 (also mentioned in BLACK, 'Should the SEC', 334).

[1760] ARLEN and CARNEY, 'Vicarious Liability', 691. See also: FRIED and SHILON, 'The Dodd-Frank clawback and the problem of excess pay", 15 ("Empirical studies consistently report a systematic link between inflated earnings and executive stock sales" and "it is not difficult to find examples of executives who have misreported financial results to boost their bonuses".). The authors also included several examples to illustrate the link between inflated earnings and executive stock sales (p. 16).

[1761] GIUDICI reports that accounting manipulation is often motivated by (deceptively) increasing a firm's performance in order to pocket individual monetary rewards, to obtain more favorable loans for the company, comply with terms set out with regard to current loans, buy up other companies, and – in the most serious cases – mask difficulties and trouble (G. GIUDICI, 'Auditors' multi-layered liability regime', 13 *EBOR* 2012, iss. 4, 525); similar: ALEXANDER, 'Rethinking Damages', 1498. A clear example of accounting fraud (at least partly) motivated by boosting stock prices for personal enrichment through stock options is the aforementioned Enron and Fanny Mae cases (see *supra*). See on stock options as a motivation for fraud also: BRATTON and WACHTER, 'Political Economy', 106; and LANGEVOORT, 'Leaving Corporate Executives', 635. Other illustrations of the problem have also been reported by COFFEE, 'Reforming Securities Class Action', 1552 (ftn. 71 in particular), 1562.

[1762] This is also the reason why disgorgement is (occasionally) sought against corporate insiders who benefited from inflated stock prices by means of performance-based compensation, but not against corporate defendants who do not profit from the price distortion besides (temporary) increased market capitalization. See also: BLACK, 'Should the SEC', 322.

[1763] "The problem is that executives themselves will not be deterred from misconduct when their personal gain from perpetrating or concealing the fraud exceeds the impact they would suffer should the corporation have to pay." LANGEVOORT, 'Leaving Corporate Executives', 635. See also: BAKER and GRIFFITH, *Ensuring corporate misconduct*, 60 (nothing that only extreme misconduct triggers criminal prosecution). See in this regard also: DAVIES, 'Liability for misstatements', 308, observing that until 2010, apparently only one criminal prosecution in relation to false statements to market had been successfully instituted.

[1764] BAKER and GRIFFITH, *Ensuring corporate misconduct*, 50.

insurance practices is nonetheless clearly discernible in this system and has triggered criticism in the US, whereas concern has risen (to a more limited extent) in Europe as well.[1765]

C. Conclusion with regard to US securities litigation experience

518. The findings allow for the conclusion that private enforcement of securities laws as it operates within the US legal system shows significant shortcomings undermining the underlying goals of the system, being compensation and deterrence. The prevailing feeling amongst academics is therefore unsurprisingly that securities litigation as practiced in its current form in the US falls short of the expectations and objectives it is supposed to attain.[1766] It was observed that the finding that only the issuer is called to account for the loss causes two major obstacles undermining the effectiveness of the system. On the one hand, it fails to deter those with the strongest incentives to engage in misreporting, whereas at the same time, it creates circular wealth transfers between groups of shareholders, undermining the compensatory effect. This conclusion is broadly shared by both opponents and proponents of fraud on the market-class actions and private enforcement of securities law in general, leading to the conclusion that adjustments are needed. No consensus has been reached with regard to the kind of adjustments and improvements that are needed however. Suggested solutions range from abandoning private securities class actions and reorient towards a stronger role for public enforcement, over abolishing the fraud on the market-doctrine, to amend rather than abolish the current system in various manners.[1767]

519. These findings should put (EU) countries on guard when considering investor litigation as a means to strengthen the overall enforcement of securities regulation. Although it is repeated that US and EU legal systems differ substantially in various aspects, the US experience with regard to the impact of insurance and circularity on the overall efficiency and effectiveness of investor litigation should not be neglected or trivialized, but may instead urge policymakers to learn from the US experience in designing their own liability regimes. Potential alternatives and solutions attenuating the problems and hurdles for effective deterrence and compensation are examined in the text below.

D. Solutions and alternative approaches to improve the enforcement of securities laws

[1765] Moral hazard in this context refers to the tendency of insurance protection to alter the insured's attitude towards loss prevention and caution exercised to prevent losses from emerging. See in this regard also: S. SHAVELL, 'On moral hazard and insurance', 93 *QJE*, 1979, iss. 4, 541. Extensively on moral hazard concerns in the context of D&O-insurance: BAKER and GRIFFITH, *Ensuring corporate misconduct*, 60 ff.; see in this regard also: M. PETRIN, 'The Curious Case of Directors' and Officers' Liability for supervision and management: exploring the Intersection of Corporate and Tort Law', 59 *Am. U. L. Rev.*, 2010, iss. 6, 1705-1706. With regard to France see also: SPITZ, *La réparation*, 202-203. With regard to the Netherlands: DE JONG, *Schade door misleiding*, 375; WETERINGS, 'Bestuurdersaansprakelijkheid', 57.

[1766] Similar: JACKSON and ROE, 'Public and Private Enforcement', 5 ("[…] the conventional legal academic view, which we share, is that securities litigation, at least as practiced within the United States, is seriously compromised."); similar: ROSE, 'Reforming Securities Litigation Reform', 1301; BRATTON and WACHTER, 'Political Economy', 69.

[1767] Opposing private enforcement of Rule 10b-5 and hence advocating the abolition of the fraud on the market-doctrine in favor of a shift towards public enforcement: BRATTON and WACHTER, 'Political Economy', 69; similar, yet considering the abolition of FOM-class actions politically infeasible: ROSE, 'Reforming Securities Litigation Reform', 1301. Criticizing the current Rule 10b-5 liability regime in the US, yet proposing to amend rather than abolish: COFFEE, 'Reforming Securities Class Action', 1534; FOX, 'Civil Liability', 237.

1. Increased enforcement of director and executive responsibility

520. The findings show that the design of effective private securities law enforcement requires a thorough understanding of the various mechanisms operating in this system and measures to correct it. One of the major takeaways from the US experience in liability for secondary market disclosures boils down to the conclusion that flaws in the framework, being circularity, an overly low deterrent effect and related to that, potential moral hazard concerns have at least one major common cause, being the issuer invariably paying the damages. One of the main problems more particularly lies with the fact that compensation is virtually always funded at the issuer's – and therefore eventually the shareholders' – expense, even though the latter do not reap the benefit of the wrongdoing, while corporate officials only rarely contribute to the settlement fund and are insured – again at the expense of the issuer – for this kind of costs and damages anyway, provided that outright fraud is not proven and adjudicated in court. The fact that executives are insulated from the financial consequences of their potentially harmful actions, causing the emergence of moral hazard concerns as executives are no longer encouraged to act carefully to avoid the occurrence of this kind of loss. Hence, a solution to this problem inevitably requires the design of a system that better allocates risks and responsibility, especially with regard to executives, experts and other third parties who may have staged, contributed to or aided or abetted the misreporting.[1768] Besides an increased deterrent effect, beneficial compensatory effects may be generated too since circularity concerns would be reduced when executives and third parties contribute to remedy the loss.[1769]

521. A first obstacle to be considered in this regard concerns the fact that issuers are currently more frequently sued than corporate officials in Europe, not in the least because issuers often have the deepest pockets, but also because statutory liability regimes have been observed to limit their reach to issuers as potential defendants. Notable examples include the German liability rule laid down in §§37 b, c WpHG (ad hoc disclosure) and the UK liability measure regarding continuous information obligations in s.90A FSMA. Both liability regimes provide a private statutory cause of action for aggrieved investors, yet exclude the possibility to file claim against other persons than the issuer. Hence, to sue directors and officers investors have no choice but to turn to the general liability regime, such as §826 BGB in Germany or the torts of negligent misrepresentation and deceit in the UK, which implies that obstacles that caused the legislator to enact specific and tailored regimes in the first place are likely to bar chances on success.

522. Various evolutions are nonetheless ongoing on both sides of the Atlantic in this regard, including the emergence of a more critical stance vis-à-vis boards and executives in terms of stricter regulation and case law rendering liability more probable.[1770] Reference can for instance be made to several legislative initiatives in the Member States, such as the Danish renewed Companies Act (into

[1768] (US) COFFEE, 'Reforming Securities Class Action', 1572; BRATTON and WACHTER, 'Political Economy', 107; FOX, 'Civil Liability', 284; (Germany) HANNICH, 'Quo vadis, Kapitalmarktinformationshaftung', 452; HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 121; HOPT, 'Die Haftung für Kapitalmarktinformationen', 109. Extensively on this topic: J. KANNEGIEßER, *Die Vorstandsaußenhaftung für fehlerhafte Kapitalmarktinformationen*, Baden-Baden, Nomos, 2011; (France) SPITZ, *La réparation*, 204.

[1769] Idem.

[1770] With regard to the UK, see for instance the recent UK Government discussion paper, Department for Business, Innovation & Skills, Transparency & Trust: Enhancing the transparency of UK company ownership and increasing trust in UK business, July 2013, https://www.gov.uk, 72, considering whether granting courts the power to make compensatory awards against directors in certain circumstances (such as insolvency). See in this regard also: HOPT, 'Die Haftung für Kapitalmarktinformationen', 108-109.

effect from 1 March 2010), which puts a stronger emphasis on the responsibility of the board of directors and management.[1771] In Germany as well measures aimed at reinforcing the effect of shareholder litigation against the board were enacted, along with stricter rules on director compensation.[1772] At the EU level, a similar tendency is observed, illustrated by the recently published study on directors' duties and corresponding liabilities commissioned by the European Commission in order to gain a comprehensive understanding on the drivers of directors' behavior.[1773] Courts seem to have tightened their stance as well. The French Supreme Court for instance recently facilitated investor claims filed against directors, whereas in the Netherlands directors have been found liable for the loss suffered by investors following misrepresentations architected by these directors.[1774] In the US as well, various measures have been enacted with the effect of increasing directors' and officers' exposure to liability and other sanctions following inappropriate behavior.[1775]

523. Some have asserted that a prohibition on D&O-insurance with regard to wrongful secondary market statements would offer a solution, provided that liability risks imposed on corporate officials are otherwise limited, for instance by capping damages in a sensible manner.[1776] Although risk and responsibility should indeed be aligned, it should also be taken into account that D&O-insurance has considerable benefits and advantages too. It was already explained that without D&O protection, corporate officials may be unwilling to take certain strategic decisions in companies out of fear for potential liability risks, whereas companies may incur serious difficulties to attract the individuals they

[1771] The act has been felt to clarify as well as tighten liability vis-à-vis the board of directors and management team. See more extensively: E. WERLAUFF, 'Boards of Director's and Management's liability in law in Denmark: The written standard's gradual superseding of the unwritten', 8 *European Company Law*, 2011, no. 6, 240.

[1772] Gesetz zur Angemessenheit der Vorstandsvergütung von 31 Juli 2009, BGBl. I S. 2509 (Nr. 50) (or "VorstAG"). The act came into force on 5 August 2009 and requires D&O-insurance to provide for a mandatory deductible with upper and lower limits, promoting durable company growth and responsibility on the side of the board. The supervisory board is required to take stricter rules into account in setting executives' compensation, while its liability for allowing inappropriate compensation is expressly mentioned. With regard to VorstAG, see, amongst others: G. ANNUSS and I. THEUSINGER, 'Das VorstAG – Praktische Hinweise zum Umgang mit dem neuen Recht', *BB* 2009, heft 46, 2434. On the introduction of mandatory deductibles, see also further below.

[1773] The study was complete in April 2013 and will be used to support the Commission's future policy in this area of law. GERNER-BEUERLE, PAECH and SCHUSTER, Study on Directors' Duties and Liability, 396 p. (individual country reports of all Member States are also available at http://ec.europa.eu).

[1774] With regard to the French decision: Cass., Comm., 9 March 2010, Jurisdata 2010-001500, (SA EPF Partners/A.), *La Semaine Juridique Entreprise et Affaires*, 2010, n° 20, Mai, 1483, with annotation by S. SCHILLER. See in this regard also: SPITZ, *La réparation*, 195. With regard to the Netherlands: Rb. Utrecht, 15 February 2012, LJN BV3753, *Ondernemingsrecht* 2012, afl. 6, 267, with ann. BY B. DE JONG; *JOR* 2012/243, with annotation by J.H.M. WILLEMS; JACOBS, 'Rechtbank Utrecht inzake Fortis', 116 (the decision has been appealed); Y. BORRIUS, 'Directors' Liability: The Netherlands', 8 *European Company Law*, 2011, iss. 6, 246. With regard to Belgium, see for instance: S. MICHIELSEN, 'Vak van bestuurder en manager is niet zonder risico', *De Tijd*, 18 Feburary 2012, observing a more critical attitude by courts vis-à-vis managers and directors, resulting in an increased liability risk. Reference can also be made in this regard to: HOPT, 'Die Haftung für Kapitalmarktinformationen', 109, observing that an evolution towards the liability of (the board of) directors, at least in exceptional cases, may be underway. With regard to the UK, reference can be made to MCDERMOTT, Director of Enforcement and Financial Crime of the UK FCA who declared that "fining firms alone is not enough" to ensure compliance, and that "in order to achieve credible deterrence, senior managers must be held to the account". The statement was made in a speech and relates to the FCA's aim to drive a change in culture in financial services, and particularly the controversial PPI (payment Protection Insurance) mis-selling scandal, the pursuit of short-time revenue, manipulation of benchmarks (LIBOR-scandal), and using information driven by self-interest or the benefit of the firm. It is also stated that in 2012/13, the FCA took more actions against individuals than against firms. See in this regard: T. MCDERMOTT, Enforcement and Credible Deterrence in the FCA, 2013, June 18, Thompson Reuters Compliance & Risk Summit, London, available at: http://www.fca.org.uk.

[1775] Executive compensation has been regulated by Sarbanes-Oxley and more recently, by the Dodd-Frank Act, which revisited and amended some of the SOX-rules (e.g. clawbacks). An overview of these measures is comprehensively discussed in: S.M. BAINBRIDGE, *Corporate governance after the financial crisis*, New York, Oxford University Press, 2012, 122 ff.

[1776] FOX, 'Civil Liability', 287.

want without any D&O coverage.[1777] Moreover, while a general prohibition on D&O-insurance in the context of secondary market statements is not only quite extreme, it is probably politically unfeasible too.[1778] Furthermore, since the adverse effects of D&O-insurance can be curtailed as effective, yet with far less radical consequences, by introducing (meaningful) deductibles as argued further below, such prohibition seems too far-reaching and rather superfluous.

524. Summarized, redirecting liability risk towards individuals responsible for secondary market misstatements may mitigate circularity (to some extent) as well as increase deterrence substantially, while the evolution towards greater managerial liability appears already set as part of broader, contemporary evolution tightening up regulation and control on boards and executives. Whereas shifting some of the liability risk from issuers or third parties towards corporate officials is considered expedient from a policy perspective by a wide range of scholars, no consensus has yet been reached with regard to the matter how it should be done. Some have suggested a system of derivative claims brought on behalf of the issuer against corporate officials[1779], the unavailability or limitation of D&O-insurance or disclosure and signaling techniques informing the public of the internal corporate culture, insurance coverage details and the like to stimulate better corporate governance practices and the installment of fraud prevention mechanisms in the companies.

2. Increased managerial responsibility: mechanisms and techniques

a. Derivative shareholder actions

525. Derivative shareholder actions. – One line of thinking has turned towards derivative actions to improve the current (US) liability system. FOX for instance suggested that issuers should be excluded from liability, except in those cases in which they engaged in trading or offering securities (and therefore reaped benefits of distorted stock prices). [1780] Instead it is suggested to put director and officer liability in a more central position, accompanied by an external entity, such as an investment bank or another well-capitalized entity with financial expertise that guarantees the accurateness of the annual reports together with the directors and officers. As D&O-insurance has the effect of "taking money out of one pocket and putting it back in the other", FOX states that the success of the suggested liability system is predicated on the prohibition of D&O-insurance and suggests to instead limiting the liability risk by capping damages in a sensible manner.[1781] Furthermore, shareholder suits against corporate officials should be brought on behalf of the company, implying that the proceeds of such claims should go to the issuer, to the benefit of all its shareholders.

526. US clawbacks introduced by §954 Dodd-Frank. – Another example aimed at restoring the shareholders indirectly as well as reducing executives' incentives to inflate stock prices through misreporting is the clawback provision enacted pursuant to §954 Dodd-Frank.[1782] According to §954

[1777] *Supra,* para. 510.

[1778] As DAVIES points out with respect to the UK context, the odds that such a prohibition would be passes are highly unlikely due to the legal environment in the UK. (DAVIES, 'Liability for misstatements', 304-305). Similarly pessimistic on the feasibility of limitations or prohibitions on D&O-insurance: DE WULF, 'Aandeelhoudersvorderingen', 520.

[1779] FOX, 'Civil Liability', 290; R. BOOTH, 'The end of the securities fraud class action as we know it', 4 *Berkeley Bus. L.J.*, 1.

[1780] FOX, 'Civil Liability', 279.

[1781] *Ibid.*, 287.

[1782] §954 Dodd-Frank (adding §10D to the Securities Exchange Act). See more extensively on the clawback provision: BAINBRIDGE, *Corporate governance after the financial crisis*, 122 ff.

Dodd-Frank, companies listed on national exchanges must provide for clawbacks that are to be exerted in case statements of earnings, revenues, gains and the like, are inaccurate. Following the discovery of the inaccuracy, executives are required to return the "excess" compensation that they have received in the three year-period prior to the date of the required disclosure.[1783] Under penalty of being delisted, companies must disclose and implement their clawback policy.[1784] The company itself is also required to seek reimbursement of "excess" compensation paid to executives, or alternatively, shareholders may be allowed to pursue the enforcement of §954 Dodd-Frank via derivative actions.[1785] By leaving the implementation to the company – or its shareholders – itself rather than attributing the right to enforce the clawback provision to the SEC, §954 Dodd-Frank differs from the earlier clawback provision enacted in §304 SOX.[1786] A final note, however, concerns the concept "excess compensation" as employed in §954 Dodd-Frank. Excess compensation is defined as incentive-based compensation paid by the firm in excess of what would have been paid to the executive in absence of the misconduct. As noted in the literature, this clearly includes bonuses paid out to executives by the firm when the executives inflated the earnings in order to boost his payout, yet it does not seem to include the proceeds of stock sales against inflated prices.[1787] Unsurprisingly, the finding that the proceeds of stock sales against inflated prices is likely excluded from the definition has drawn criticism and raised doubt as to the effectiveness of the rule.[1788]

527. Evaluation in the light of shareholder derivative actions in Europe. – Although a system of derivative actions might sound appealing at first glance, derivative actions have rarely proven a successful tool in EU Member States. Various reasons can be pointed out to explain the scarcity of derivative actions in European countries, such as ownership thresholds required to be eligible to file and, most notably, rules requiring suing shareholders to advance the costs of the procedure and precluding them from recovering the costs in case of rejection of the claim.[1789] Additionally, derivative suits are also characterized by a typical collective action problem because the proceeds of successful

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[1783] Idem.

[1784] According to §954 Dodd-Frank, the SEC has to direct the exchanges delist the securities of issuers that have not developed and implemented compensation claw-back policies.

[1785] No implementing rules of the SEC have been promulgated yet with regard to §954 Dodd-Frank (last consultation of the SEC official website on October 15, 2013).

[1786] §304 Sarbanes-Oxley introduced a clawback provision, imposed on CFO's and CEO's of public listed companies and to be exerted in the event that a corporation is obliged to restate its financial statements as a result of misconduct. More particularly, to the extent misconduct is established, the CEO and CFO are required to return to the issuer any bonus, incentive-based or equity-based compensation they received during the twelve months following the original disclosure, along with any profits realized from the sale of securities of the issuer during that twelve month period. Pursuant to §954 Dodd-Frank, the clawback-provision was further extended however, holding that publicly listed companies must provide for clawbacks for any "excess" compensation that executive officers have received in the three year period prior to the date of the required disclosure (§304 SOX).

[1787] FRIED and SHILON, 'The Dodd-Frank clawback and the problem of excess pay", 15, 20-21 in particular (also available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1953317); J. ANG, Y. CHENG and S. FULMER, Clawing Back Executive Compensation, 2012, available at SSRN: http://ssrn.com/abstract=2139818, 57 p.

[1788] Idem.

[1789] Idem. GELTER for instance asserts that a combination of factors explains the unattractiveness of the derivative suit in European countries, including litigation cost structure, availability of information, standing requirements and ownership thresholds to litigate. M. GELTER, 'Why do Shareholder Derivative Suits Remain Rare in Continental Europe?', 37 *Brook. J. Int'l L.*, 2012, no. 3, 843.

claims are passed on to the group of shareholders as a whole, whereas the efforts and potentially the costs in case of dismissal are borne exclusively by the initiators of the claim.[1790]

Summarized, the reasons as to why shareholder derivative action is not frequently used as an instrument to obtain compensation and enforce shareholder rights relates to the fact that the incentives of shareholders to sue for the benefit of the company are usually quite low because of the risk of incurring personal costs, whereas the gain benefits the whole group of shareholders, including those remaining passive.[1791] For these reasons, we do not consider shareholder derivative actions sufficient as a solution to the circularity and deterrence concerns.

b. (Ex ante) *Signaling mechanisms: the corporate governance approach*

528. It was stated above that moral hazard concerns may be countered by designing a system that still allow issuers to offer D&O-insurance, yet with the assurance that in certain circumstances the executives and corporate agents can still be held accountable for their wrongs.[1792] Some have proposed indirect mechanisms in this regard, aimed at revealing the chance of fraud in a certain company to the public one way or another. BAKER and GRIFFITH for example suggest requiring listed companies to disclose their D&O-insurance policies, and specifically to make the details such as premiums, limits, and retentions as well as the identity of the insurer publicly available.[1793] The authors particularly consider the publication of those data helpful based on their findings that insurers seek to seek to price insurance coverage dependent on the risk assessment of D&O professionals, which they find is significantly based on the governance quality. Insurers more particularly demand information on the company's corporate governance culture in general, the intern information flow and the quality of the information and take this information into account in determining the insurance premium. Hence, the authors assert that the premiums actually reflect the insurer's assessment of how well the company is governed.[1794] Disclosing the premium would thus inform the market of the insurer's assessment of a given company's governance system and may influence the public's appetite to invest. As a result, corporations would be stimulated to install well-functioning governance structures that could counter the moral hazard effect that may stem from D&O-insurance practices, according to the authors.[1795]

[1790] GERNER-BEUERLE, PAECH and SCHUSTER, Study on Directors' Duties and Liability, xiii, observing that "enforcement of the company's claims through shareholders by means of a derivative action faces a collective action problem: the costs are borne by the shareholders who bring the action, while the passive shareholders benefit from the claimant's efforts."

[1791] (UK): Extensively on (the lack of) derivative shareholder litigation: A. KEAY and J. LOUGHREY, 'An Assessment of the Present State of Statutory Derivative Proceedings', J. LOUGHREY, *Directors' Duties And Shareholder Litigation In The Wake Of The Financial Crisis*, Cheltenham, Edward Elgar, 2013187; KEAY and LOUGHREY, 'An Assessment of the Present State of Statutory Derivative Proceedings', 6 ff.; DAVIES, 'Liability for misstatements', 306; A. REISBERG, *'Derivative actions and corporate governance: theory and operation'*, Oxford, Oxford University Press, 2007, 121. A similar low use of derivative actions has been observed in Italy: FERRARINI and GIUDICI, 'Financial Scandals', 202; and in Belgium: DE WULF, 'Aandeelhoudersvorderingen', 488 ff. On the unsuccessful track record of derivative suits in Europe in general, see also: GELTER, 'Shareholder Derivative Suits', 843; and a recent study commissioned by the European Commission on directors' duties and liability, holding that "the data indicate that enforcement levels are low in all Member States", see: GERNER-BEUERLE, PAECH and SCHUSTER, Study on Directors' Duties and Liability, 192.

[1792] *Supra*, para. 523.

[1793] BAKER and GRIFFITH, 'Uncovering a gatekeeper', 1147 ff; BAKER and GRIFFITH, 'Predicting Corporate Governance Risk', 536; BAKER and GRIFFITH, *Ensuring corporate misconduct*, 203 ff.

[1794] Idem.

[1795] A somewhat different proposal, yet with similar goals in terms of encouraging corporate officials to invest in improved corporate governance structures, goes a step further and suggests levying a fraud premium on each transaction carried out in secondary markets. The proceeds of the premiums are to be gathered in a fund, which can be used to fund compensation for investors suffering losses following misreporting. The premiums charged for the transactions should be based on the fraud

Taking into consideration however that insurers have been found to only partly succeed in assessing a given company's litigation and fraud risk while the effectiveness of this solution depends on the accurateness of such assessments, this solution has been put to doubt by critics.[1796] It was particularly asserted that to the extent that insurers' assessments of fraud risks make poor indicators for a company's internal corporate governance, its disclosure to the public is not particularly helpful.[1797]

c. *Incomplete or partial insurance coverage*

529. Coinsurance and deductibles. – A final – and in our regard more promising – possibility to reduce moral hazard and shift part of the liability risk to the executives and corporate agents is to amend the current D&O-insurance mechanism in the sense that when certain conditions are met, the damages cannot be fully passed on as easily to the issuer anymore.[1798] This can for instance be done through coinsurance techniques or deductibles that allocate the loss between the insurer and the insured.[1799] More particularly, by means of coinsurance or deductibles a predetermined percentage of the loss or a fixed amount of money is imposed on the insured, while the insurer covers the remaining costs and damages. It is noted that deductibles are already applied in the context of D&O-insurance, although it has been observed that US D&O policies set rather low deductibles which furthermore only apply to side B and side C coverage, but customarily not with regard to side A D&O coverage, which is the coverage that protects directors and officers against personal liability.[1800] Proposals to limit insurance coverage for (side A) D&O-insurance have been advanced in the US literature[1801], but

risk rating attributed to the issuer has and determined by an independent risk rating agency, based on criteria such as corporate governance, disclosure-related business practices, such as internal control system, history of fraud investigations and enforcement actions, paid outs of compensation in the past. The fee thus serves as a signal to the investor public regarding the reliability of the company on the one hand, and a financial incentive to trade in instruments issued by firms that are considered more reliable on the other hand. As such, executives and managers are incited to reduce the premium as much as possible, for instance by installing and monitoring the control mechanisms aimed at preventing the incidence of fraud. According to the author, this *ex ante* method of fraud deterrence will resort more effect than the current *ex post* method through litigation, and will also contribute to increase the low amounts of compensation through the availability of the investor fund that pools the proceeds of the premiums. See in this regard: EVANS, 'Investor Compensation Fund', 223. The system advanced by EVANS differs from the one suggested by BAKER and GRIFFITH as it includes the establishment of a fund to increase compensatory function of liability in addition to the deterrence objective. Whereas this may contribute to provide more compensation, it is also more complicated and costly as it requires the SEC to act as governing authority of the fund, increases the costs of trading on secondary markets while the compensation nonetheless remains circular in essence.

[1796] T. HAVINGA, 'Ensuring Corporate misconduct', *Recht der Werkelijkheid*, 2012, nr. 2, 83, finding that the solution suggested by Baker and Griffith with regard to the mandatory disclosure of insurance policies "seem to rest on the same assumptions that, according to the previous chapters, did not in fact work."

[1797] It is noted that this proposal advanced by BAKER & GRIFFITH is part of a number of considerations suggested to improve the current shareholder litigation system, including a proposal to consider partial D&O insurance, as also suggested in this thesis. See: BAKER and GRIFFITH, *Ensuring corporate misconduct*, 200 ff.

[1798] An alternative proposal to intervene in the D&O-insurance insurance practice was advanced by Coffee, who suggested dropping the entity coverage practice and instead ensuring that different insurers are covering for the corporation and the corporate agents. That way, the fraud exception would be applied to an increasing extent since the insurer is not risking losing the company as a client anymore. Questionable practices and objectionable behavior would therefore more often result in financial contributions by individuals responsible for those practices and behavior. See in this regard: COFFEE, 'Reforming Securities Class Action', 1580.

[1799] Moral hazard is typically reduced by gathering information on the insured's precautionary behavior and condition the insurance certain behavior, which is not evident and brings an added costs. Another way is to provide output-based incentives, such as partial insurance in case of occurrence of the insured event by means of deductibles of instance. It is the second type of solutions that is focused on here. See on moral hazard and solutions in general: H.E. JACKSON, L. KAPLOW, S.M. SHAVELL, K. VISCUSI and D. COPE, *Analytical methods for lawyers*, New York, Thomson Reuters/Foundation Press, 2011, 47 ff.

[1800] BAKER and GRIFFITH, 'The Missing Monitor', 1804, ftn. 38 in particular.

[1801] See for instance the proposal of BAKER and GRIFFITH to introduce coinsurance as a means to reduce the moral hazard concern: BAKER and GRIFFITH, *Ensuring corporate misconduct*, 222-223.

also exist as mandatory requirements in NY state law[1802], and, perhaps even more interesting from a European angle, in Germany since 2009.

530. Following the promulgation of the Act on the Adequacy of Management Board Compensation[1803] German public companies[1804] concluding D&O-insurance contracts for their board members are required to include a compulsory deductible in the contract. The deductible must amount to a minimum of 10 percent of the damages and is capped at 150 percent of the fixed annual compensation ("*feste jährliche Vergütung*") of the executive.[1805] The mandatory deductible-rule was introduced in the aftermath of the financial crisis along with other rules aimed at spurring more diligence amongst board members as well as fixing the misaligned incentives caused by the remuneration structure of board members.[1806] According to the German legislator, one of the lessons to be drawn from the crisis was that then current compensation packages elicited short term visions, for instance by encouraging excessive risk taking to push share prices, to the detriment of a sustainable and durable company development.[1807]

531. Overall, the introduction of deductibles may offer an interesting instrument to increase deterrence since it also allows setting certain standards that may prevent boundless, excessive liability

[1802] § 726(a)(3) New York Business Corporation Law (BCL): "[...] a corporation shall have power to purchase and maintain insurance: [...] (3) To indemnify directors and officers in instances in which they may not otherwise be indemnified by the corporation under the provisions of this article provided the contract of insurance covering such directors and officers provides, in a manner acceptable to the superintendent of insurance, for a retention amount and for co-insurance." 11 NYCRR §72.4 This arrangement also contains a layered system to determine the amount of the deductible (or retention amount as it is referred to in this legislation). The New York statutes regulates the (Side A) D&O-insurance more strictly and more narrowly than the Delaware rules. See with regard to the NY state law system also: WETERINGS, 'Bestuurdersaansprakelijkheid', 571.

[1803] Gesetz zur Angemessenheit der Vorstandsvergütung von 31 Juli 2009, BGBl. I S. 2509 (Nr. 50) (or "VorstAG"). The act came into force on 5 August 2009 and applies to new D&O-insurance contracts as well as existing contracts as of 30 June 2010. The arrangement has been incorporated in the German Companies Act in a new §93 Abs. 2 S. 3 AktG. See on this requirement amongst others: KOCH, 'Einführung eines obligatorischen Selbstbehalts in der D&O-Versicherung durch das VorstAG', 637; M. HENSSLER and L. STROHN (eds.), *Gesellschaftsrecht*, München, Beck, 2011, AktG §93, para. 55 ff.

[1804] The rule applies more particularly to the "*Aktiengesellschaft*" ("AG"), being a stock corporation, listed or unlisted, with a two-tier board structure separating the management function from the supervisory function. Whereas the management board ("*Vorstand*") is responsible for the management of the corporation, the supervisory board ("*Aufsichtsrat*") is the organ that nominates, supervises and advises the management board. Other types of German corporations are expressly excluded, such as the limited liability company ("*Gesellschaft mit beschränkter Haftung*" or "GmbH"). With regard to the AG and it organization, consult: WINDBICHLER, *Gesellschaftsrecht*, München, Beck, 2009, 283 ff. and §27 with regard to the *Vorstand*, §28 with regard to the *Aufsichtsrat*; T. RAISER and R. VEIL, *Recht der kapitalgesellschaften*, München, Vahlen, 2010, 27 ff. and §13 with regard to the organization, §14 with regard to the *Vorstand*, §15 with regard to the *Aufsichtsrat*. The rule regarding the compulsory deductibles laid down in §93 Abs. 2 S. 3 AktG applies to members of the management board, and not with regard to members of the supervisory board.

[1805] §93 Abs. 2 S. 3 AktG. The minimum of 10 percent applies to each individual damages, the maximum of 150 percent of the fixed annual compensation applies to the total of the damages in a particular year. These upper and lower limits concern the damages only and not the legal expenses made to defend or appeal a claim such as lawyers' fees for example.

[1806] See on this motivation also Y. HAUSEMANN and E. BECHTOLD-ORTH, Changing remuneration systems in Europe and the United States: a legal analysis of recent developments in the wake of the financial crisis", 11 *EBOR* 2010, iss. 2, 195; TALAULICAR, 'D&O Deductibles', 147. It should be noted that prior to the enactment of the mandatory rule, the rule already existed as part of the (non-mandatory) German Corporate Governance Code (s.3.8). No specific upper or lower limit was set by the code, instead the rule was limited to a 'suitable' deductible only, yet without further specification of what is considered suitable.

[1807] Note that the German legislator also provided for deductibles of 50 percent in case D&O insurance was to be applied to cover for losses suffered by investors following misleading continuous reporting in its draft legislation KapInHaG that failed to become enacted (draft: §37a BMF, Diskussionsentwurf eines Gesetzes zur Verbesserung der Haftung für falsche Kapitalmarktinformationen (Kapitalmarktinformationshaftungsgesetz - KapInHaG), 2004, NZG (1042) 1043. See in this regard also: HELLGARDT, *Kapitalmarktdeliktsrecht*, 394; SETHE in ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §37b, c WpHG, para. 26.

on individuals.[1808] For instance, searching for an effective yet not over-deterrent system might bring up the question whether the deductible should apply in all circumstances, or whether a particular standard of negligence or complicity should be required in order for the deductible to apply.[1809] Another possibility in this regard may involve different percentages of deductibles depending on whether it concerns (gross) negligence or another standard of liability. Furthermore, the reach of the arrangement can be limited to continuous reporting, and could also include other professionals involved, such as expert accountants drafting the annual accounts. Another issue to be considered concerns the upper and lower limits of the deductibles. Put differently, the practical implementation of a system involving deductibles leaves room for tailored arrangements dependent on policy choices.

532. Summarized, partial insurance through capped deductibles may offer a (partial) solution to the problem, although much more research is needed to clarify how it can operate as effective and efficiently as possible. Secondly, although a shift in responsibility towards executives may be required in respect of the effectiveness of the system, especially in those cases in which corporate officials have benefited and/or were complicit in the fraud, it should also be understood that individuals lack the 'deep pockets' that companies generally dispose of to pay out compensation. Put differently, individual liability cannot fully support the total compensation the victims may claim.[1810] Liability caps may provide adequate protection in this regard.[1811]

533. As a final remark, it is mentioned that some have asserted that 'managerial liability' is a paradox that cannot be solved really, since any attempt would turn out vain and pointless as executives will simply recoup the potential increase in costs by means of a higher salary or perks that come with the job.[1812] Opinions on the matter are divided however. COFFEE for instance points out that (in the US) managerial compensation is already relatively high and the additional risk is unlikely to deter capable managers.[1813] Secondly, even if compensation rises, managers and other agents still face the risk of losing their pay rise when they engage in disputable practices and deductibles are triggered, providing an incentive to abstain anyway.

[1808] See with regard to the imposition of liability on board members vis-à-vis shareholders also: K.J. HOPT and H.C. VOIGT, 'Empfehlungen', K.J. HOPT and H.C. VOIGT, *Prospekt- und Kapitalmarktinformationshaftung*, Tübingen, Mohr Siebeck, 2005, 6. Critical towards liability imposed on the board with regard to misleading capital market information on the other hand: CASPER, 'Significance of the Law of Tort', 104 ff.; and: SETHE (discussing the topic in the context of the failed draft of legislation KapInHaG) in ASSMANN and SCHNEIDER (eds.), *Wertpapierhandelsgesetz Kommentar*, §37b, c WpHG, para. 27.

[1809] See in this regard: (Germany) HANNICH, 'Quo vadis, Kapitalmarktinformationshaftung', 455 (arguing in favor of a standard set at gross negligence rather than intent).

[1810] COFFEE, 'Reforming Securities Class Action', 1538 ("[…] this Essay maintains that the goal of deterrence requires the imposition of significant financial damages, but argues that, to the extent possible, the incidence of such damages should be shifted so that they fall more on the culpable (and less on the innocent). To be sure, any such reallocation can be only marginal, but even a modest change could be sufficient to deter."); SPITZ argues in this context the combined liability of both corporate officials and the issuer should ensure that those who need to be deterred are deterred from engaging in misconduct that results in inflated securities prices, whereas the issuer's deep pockets (or those of an insurer) provide for compensation vis-à-vis the investors. It is suggested to cap liability of the executives in function of their remuneration, while executives should be excluded from insurance for these amounts. The issuer should cover for the rest of the compensation, while this defendant is allowed to insure against this loss and hence shift the loss to the insurer, according to SPITZ. See in more detail SPITZ, *La réparation*, 203-204. HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 123.

[1811] HOPT and VOIGT, 'Grundsatz- und Reformeprobleme', 123.

[1812] EASTERBROOK and FISCHEL, 'Optimal damages', 640.

[1813] COFFEE, 'Reforming Securities Class Action', 1584.

3. Organization of (more) effective enforcement systems: a hybrid role for public supervisors?

534. Rather than focusing on risk allocation, another part of the US literature has focused on institutional and organizational adjustments to achieve a more effective enforcement system and advocate to abandon private enforcement as a means to enforce securities laws and entrust the public authorities with investor compensation, for instance, through disgorgements and/or civil penalties, which are then redistributed to injured investors.[1814] This kind of hybrid role for public supervisors is not new and currently operates already in the US and UK legal system. The various proposals and potential improvements are briefly discussed in the following.

535. The possibility of UK restitution orders. – Financial supervisors in the UK and US have been attributed with the power to provide redress to injured investors in certain circumstances. In the UK, the Financial Conduct Authority has been vested with the power to claim recovery before court on behalf of investors who suffered losses due to breaches of reporting requirements.[1815] More particularly, following a violation of the reporting requirements (s.382 FSMA) or market abuse regulation (s.383 FSMA) that has resulted in the accrual of profits for the violator or loss or other adverse effects for others, the FCA may apply for a restitution order to be imposed on the company or individuals, including the directors, to redress the victim(s).[1816] The court may order the wrongdoers to pay an amount as it considers fit in the given case. Under s.384 FSMA, the FCA may also require restitution without application to a court, provided that the contravention was knowingly committed. The amount is to be paid to the FCA, which then distributes the proceeds to those who suffered the loss. The supervisor decides in a discretionary manner whether or not to exercise its power to apply for or to require restitution.[1817] Although the system sounds interesting for investors, who benefit from actions initiated and paid for the FCA, the supervisor has expressed its intention to exercise its formal restitution powers only rarely and more particularly in case it is economically efficient in terms of expected costs relative to expected gains, and to the extent no other options are available to the alleged

[1814] With regard to civil penalties, see for instance: ALEXANDER, 'Rethinking Damages', 1487.

[1815] For an example, see an FCA press release announcing that the proceedings of a high court settlement will be used to return money to investors that got involved in an unlawful collective investment scheme that involved the sale of plots of a disused airfield. At least 70 investors purchased plots of land paying between £6.000 and £12.000, while the activity was not authorized as required by the FCA, which renders it unlawful. The FCA initiated civil proceedings against the companies that run the collective investment scheme and reached settlement for an amount of £380.000. The FCA plans to return this money to the investors by seeking a restitution order from the High Court. See for more details: FCA, High Court settlement paves the way for FCA to return money to investors in illegal land bank, 2013, June 21, Press Release, available at: http://www.fca.org.uk

[1816] S.382 and s.383 FSMA. See also in this regard: DAVIES and WORTHINGTON, *Gower and Davies' Principles*, para. 26-13. Prior to the establishment of the FCA, its predecessor, the Financial Services Authority (FSA) was vested with this power. See for a discussion: E.J. SWAN and J. VIRGO, *'Market abuse regulation'*, Oxford University Press, New York, 2010, para. 10.64 ff.; SPANGLER (ed.), *Investment Management*, para. 13.72; M. BLAIR, G. WALKER and R. PURVES (eds.), *Financial Services Law*, Oxford, New York, Oxford University Press, 2009, para. 7.33; RUSSEN, *Financial services*, 147, para. 5.97 ff.

[1817] Criteria to be followed in deciding whether or not to exercise its powers can be found in s.93 (2) FSMA and include factors such as the seriousness of the contravention, whether the breach was deliberate or reckless, and whether the person on whom the penalty is to be imposed is an individual. The FCA Enforcement Guide also indicates that "[w]hen deciding whether to exercise these powers, the FCA will consider whether this would be the best use of the FCA's limited resources taking into account, for example, the likely amount of any recovery and the costs of achieving and distributing any sums. It will also consider, before exercising its powers: other ways that persons might obtain redress, and whether it would be more efficient or cost-effective for them to use these means instead; and any proposals by the person concerned to offer redress to any consumers or other persons who have suffered loss, and the adequacy of those proposals. The FCA expects, therefore, to exercise its formal restitution powers on rare occasions only." FCA, Enforcement Guide, April 1st, 2013, para. 11.1.

victims.[1818] It is observed that the FCA's predecessor, the FSA, has not once been reported to have exerted its power to order restitution.[1819] In summary, even though private rights of actions relating to deficient issuer information are very rarely employed in the UK system, the public supervisor has not filled the gap by initiating compensatory proceedings through its restitutionary powers.

536. US Fair funds – In the US on the other hand, the Federal Account for Investor Restitution Funds (referred to with the acronym 'Fair Funds') was introduced by the Sarbanes-Oxley Act in 2002 (SOX), which was prompted by a series of major financial scandals such as WorldCom, Tyco, Adelphia and Enron.[1820] Whereas only disgorgements could be returned to investors prior to the Fair Funds provision, the latter enables the SEC to include civil penalties, along with disgorgements, to be distributed to injured investors at the SEC's discretion instead of being collected by the US Treasury.[1821] The penalties and disgorgements can be imposed on both individuals and corporate entities, in administrative and judicial actions, decided in an order or as a settlement term.[1822] In the years following its enactment, the SEC has increasingly employed fair funds to collect investor compensation, although it has been reported that less Fair Funds have been opened after 2007, while the largest Fair Funds also date back prior to 2007.[1823] With regard to issuer financial fraud and reporting violations, the SEC declared to seek to obtain penalties and disgorgements "from individuals who receive bonuses based on the misleading results of operations, sell the issuer's stock during the

[1818] See the previous ftn. See also: DAVIES and WORTHINGTON, *Gower and Davies' Principles*, para. 26-13; FERRAN, 'US-style investor suits', 307; RAVELINGIEN, Privaatrechtelijke handhaving, 101 (noting that since statutory causes of action are available to alleged injured investors, the FSA (currently FCA) is not likely to exercise this power.

[1819] DAVIES, 'Liability for misstatements', 305. Note that this has changed under the FCA (see the example mentioned in one of the previous footnotes. See in this regard also: FCA, High Court settlement paves the way for FCA to return money to investors in illegal land bank,

[1820] S.308 SOX. 'Sarbanes-Oxley' is named after the senators who drove its enactment, Sarbanes and Oxley. The act is also known as the 'Public Company Accounting Reform and Investor Protection Act' and was passed within nine months after Enron's file for bankruptcy following the break out of the accounting fraud. As the employees' retirement fund of Enron was heavy with company stocks, the collapse and bankruptcy proved catastrophic for the employees, who were considered one of the main victims of the fraud. S.308 was passed and applied to create a fair fund, to be funded with the proceeds of enforcement actions – including disgorgements and penalties – against former corporate executives (and others involved, including Arthur Andersen) that had been part of the fraudulent schemes. Several former executives and were alleged to have sold their stocks prior to the collapse knowing that the price was overvalued (the former chairman made $20.7 million exercising options in 2001, before the collapse, and more than $180 million during the three prior years). At the same time the retirement plan was promoted as an attractive investment vehicle to their employee. The finding that the executives had sold their options en masse in the months before the collapse, while the assets in the retirement fund were frozen, precluding the employees from selling, caused outrage amongst the employees and public in general. As the case proved politically sensitive, the US Congress reacted with the Sarbanes-Oxley Act, which was passed in record time. Former employees who participated in the retirement plan were given priority in the allocation of the fund. See for more details also: BLACK, 'Should the SEC', 325-326; D. CARRILLO, 'Disgorgement Plans Under the Fair Funds Provision of the Sarbanes-Oxley Act of 2002: Are Creditors and Investors Truly Being Protected?', 6 *DePaul Bus. & Com. L.J.*, 2007-2008, 331; ARMOUR and MCCAHERY, 'Introduction', 1 ff.

[1821] To the extent that the distribution of the funds to the investors is not justifiable in terms of the costs related to administering the distribution exceeding the value of the available funds, the funds may be paid to the Treasury instead. SEC Rules of Practice, 17 CFR 201.1102 (b) (2006): "When, in the opinion of the Commission or the hearing officer, the cost of administering a plan of disgorgement relative to the value of the available disgorgement funds and the number of potential claimants would not justify distribution of the disgorgement funds to injured investors, the plan may provide that the disgorgement funds and any civil penalty shall be paid directly to the general fund of the United States Treasury."

[1822] See with regard to the broad scope of s.308 c) SOX: WINSHIP, 'Fair Funds and the SEC's Compensation of Injured Investors', 1119.

[1823] From 2002 through February 2010, $9.5 billion in Fair Funds has been ordered, $9.1 billion of that total (96 percent) has been collected and $6.9 billion (76 percent) of the Funds collected has been distributed. See for concrete figures on Fair Funds: Securities and Exchange Commission, Information on Fair Fund Collections and Distributions, April 22, 2010, http://www.gao.gov/products/GAO-10-448R, 3.

relevant period, or otherwise profit from their violations".[1824] Although on its face, this aligns with what has been argued about preventing the real culprits to walk away with the profits of wrongdoing, the operation of the compensatory role imposed on the SEC is not as evident as it may seem.

537. Limited resources and staffing cause the supervisor to prioritize. – In a report dating from 2003, the SEC voices some of the difficulties and hurdles it encountered in the operation of the fair funds. The report states that various aspects of the process such as identifying potential claimants and verifying the amounts owed and the collection and distribution of the money collected, prove time-consuming and beyond the limits of the resources of the SEC.[1825] To mitigate this concern, specialized companies are being hired through court appointment to carry out these tasks. These entities are compensated for their work out of the funds gathered in the fair funds. Whenever related class actions were initiated simultaneously with SEC enforcement actions, the SEC sought to coordinate and cooperate with the private plaintiffs, as well as with other regulators when possible in order to save money and time.[1826] Notwithstanding these efforts, limited resources in combination with the different tasks the SEC is entrusted with, such as the interpretation and promulgation of rules, authorization and supervision of financial institutions and listed companies, overseeing compliance and conducting investigations, and carrying out enforcement actions in response to contraventions, require the SEC to prioritize. As a result, the SEC has focused on the most flagrant abuses, yet left less blatant wrongdoing untouched, and acknowledged that public agencies may facilitate investor compensation under certain circumstances yet it cannot adequately substitute for private investor litigation.[1827]

538. Collision of interests. – The combination of enforcement aimed at public interests with the pursuit of compensatory goals to the benefit of individual investors may also prove difficult because the preservation of public interests does not necessarily align with the private compensatory interest investors seek to satisfy.[1828] The difficulty to reconcile both interests is for instance illustrated by the observation that the SEC has mostly imposed penalties and disgorgements on corporate defendants,

[1824] SEC, SEC, Report Pursuant to Section 308(c) of the Sarbanes Oxley Act of 2002, 2003, available at http://www.sec.gov, 8. The report for instance mentions the case against Michael Saylor, the chief executive officer of MicroStrategy, Inc., who was alleged to have sold a significant amount of stock. Saylor was therefore ordered to disgorge over $8 million and pay an additional penalty of $350,000. The disgorgement was paid to contribute to the settlement fund, while the penalty was collected by the US Treasury (p. 6).

[1825] *Ibid.*, 11, 19. It is for instance reported that collecting ill-gotten gains is difficult and costly. ("An additional impediment to the Commission's ability to effectively recover ill-gotten gains is locating assets and evidence relating to assets. Defendants may hide assets in off-shore trusts or other accounts to prevent discovery of the assets. Further, finding evidence of off-shore or hidden assets is exceedingly difficult and is often compounded by defendants' refusals to comply with disclosure and production orders. In the appropriate circumstances, the Commission expends significant resources tracking down assets and compelling defendants to satisfy monetary judgments."). Adding to the problem is the finding that wrongdoers have often spent the proceeds of the wrongdoing before the SEC laid hands on it: "Furthermore, once defendants in all kinds of enforcement cases have taken profits from their fraud, they tend to spend it. The [General Accounting Office] noted in its report that in a high percentage of the cases in which violators did not pay all the disgorgement ordered, disgorgement was not collected because the violators had already spent the money on expenses that the Commission could not recover." SEC, SEC, Report Pursuant to Section 308(c), 21, with reference to the aforementioned General Accounting Office -report: Sec Enforcement: More Actions Needed to Improve Oversight of Disgorgement Collections, p. 7, GAO-02-771 (July 2002). In a similar sense: WINSHIP, 'Fair Funds and the SEC's Compensation of Injured Investors', 1131; BLACK, 'Should the SEC', 338 ("First, the SEC does not and will never have the necessary resources to investigate and bring enforcement actions against every securities violator, much less pursue every enforcement action that may result in recovery for investors"). More extensively: COX, RANDALL and KIKU, 'SEC Enforcement Heuristics', 757 and references cited; A.S. ZIMMERMAN, 'Distributing Justice', 86 *N.Y.U. L. Rev.*, 2011, 541.

[1826] BLACK, 'Should the SEC', 328.

[1827] SEC, SEC, Report Pursuant to Section 308(c), 20. The report even states that […] while the Fair Fund provision may facilitate investor compensation in some cases, in other cases private litigation remains the best mechanism for investor recovery of losses." But see on the other hand: ROSE, 'Reforming Securities Litigation Reform', 1301.

[1828] BLACK, 'Should the SEC', 338 and 341 ff.; ZIMMERMAN, 'Distributing Justice', 541.

rather than targeting individual wrongdoers.[1829] More particularly, focusing on individual perpetrators would probably increase deterrence as well as reduce circularity concerns, yet the fines imposed on individuals would obviously be smaller than those imposed on deep-pocketed corporate defendants, implying that average investor compensation would be lower.[1830] Compensating investors at the expense of issuers on the other hand raises the circularity concern once again and weakens the deterrent effect vis-à-vis actual wrongdoers.[1831] Confronted with the pressure to enforce the laws effectively and deter potential wrongdoers on the one hand, and ensuring meaningful compensation for investors on the other, the SEC apparently felt pressured to choose the latter and went after issuers with deep pockets rather than individuals, notwithstanding its proclaimed intention to focus on disgorging individual culprits. Since Fair Fund distribution is conditional upon disgorgement of measurable gains of the violator, and since issuers often do not profit from secondary market misstatements, the SEC had to overcome this obstacle by repeatedly imposing a nominal $1 disgorgement on issuers in cases involving accounting fraud, linked to a considerably larger penalty.[1832] In a response to criticism in this regard, the SEC changed its policy and set out criteria to be followed in the process of imposing fines on corporate defendants, stressing the need to assess whether (1) the corporation received direct benefits from the wrongdoing and (2) the degree to which the penalty will benefit or further harm the shareholders.[1833] With these requirements, the SEC aims to change course again and take into account the circularity effect when fining issuers.

539. Conclusion. – The conclusions that can be drawn with regard to the technique of civil penalties imposed on wrongdoers and distributed to injured investors by public supervisors are not overly promising. Although the technique could clearly offer certain advantages in terms of targeting individual wrongdoers directly via penalties and disgorgements, which would both mitigate the circularity problem as well as increase the deterrent effect, its operation in practice appears more complicated when compensatory and deterrence goals are simultaneously pursued.[1834] The difficulties supervisors encounter in this regard correspond to the traditional limits of public enforcement, being different priorities and incentives (which also tend to collide) and limited resources. With regard to

[1829] It should be noted that in accordance with s.308 SOX penalties can be distributed to the investors conditional upon disgorgement of the measurable gains that the (same) violator has made. In other words, to the extent that the violator has not profited from the wrong in a demonstrable manner, no distribution of potential civil penalties to injured investors can occur. This requirement has caused the SEC to impose a nominal $1 disgorgement in cases involving accounting fraud cases directed against issuers along with a (considerably larger) civil penalty to enable its distribution to injured investors via a fair fund. As issuers often do not benefit from this kind of fraud however, this arrangement has been prone to criticism. See in this regard: BLACK, 'Should the SEC', 327.

[1830] *Ibid.*, 344. To the extent that the costs related to the creation and administration of fair funds outweigh the collected sums of money, the SEC may even forego the creation of fair funds because of efficiency reasons.

[1831] Drawing a similar conclusion: BRATTON and WACHTER, 'Political Economy', 139 ("Fair Funds distribution to a subset of shareholders is every bit as much an exercise in pocket shifting as is payment of a FOTM settlement."); BLACK, 'Should the SEC', 331. See in this regard also: WINSHIP, 'Fair Funds and the SEC's Compensation of Injured Investors', 1128. BLACK and WINSHIP have argued in this respect that in order to mitigate the circularity concern, the SEC should focus on imposing fines on aiders and abettors since these actors, often with deep pockets, cannot be sued by private litigants under Rule 10b-5 as a result of the longstanding case law of the US Supreme Court barring claims against 'secondary' actors, aiding and abetting in the commission of the wrong. BLACK, 'Should the SEC', 344; WINSHIP, 'Fair Funds and the SEC's Compensation of Injured Investors', 1130 and 1133.

[1832] WINSHIP, 'Fair Funds and the SEC's Compensation of Injured Investors', 1119; BLACK, 'Should the SEC', 330.

[1833] SEC, Press Release, Statement of the Securities and Exchange Commission Concerning Financial Penalties, 2006, January 4, 2006-4, available at: http://www.sec.gov/, See in this regard also: BLACK, 'Should the SEC', 339-341. BRATTON & WACHTER observe that following the change in policy the imposition of fines has slowed down, which may explain why fewer Fair Funds have been opened since 2007 and a smaller amount of fines has been ordered and collected. BRATTON and WACHTER, 'Political Economy', 141. With regard to the numbers: Information on Fair Fund Collections and Distributions, 3.

[1834] Illustrated by the finding that the SEC has often targeted issuers for instance, pressured to collect sufficient amounts of compensation and render its enforcement actions as cost-efficient as possible.

efficiency considerations, it should also be noted that even though the system would allow saving on lawyers' fees (which tend to be considerable in US securities class litigation), it is unclear whether the system as a whole would be less expensive, especially since the administration of investor funds brings its own costs, while staff and budget spent on investor compensation should also be taken into account. As a result, we believe that public enforcement should remain focused on its primary tasks in terms of promoting public interests, such as market integrity and investor confidence, through a sufficiently high level of deterrence. Rather than substituting pure private enforcement by public enforcement techniques simultaneously aimed at deterrence and investor compensation, as advocated by some, public and private enforcement systems seem more useful when complementing each other.[1835] Provided that a suitable legal framework is established, compensatory goals may be taken care of by investors themselves instead of being shifted to public authorities, while the decision whether these parties are entitled to compensation and to what extent, should be left to independent courts.

540. Complementary role for public supervisors with regard to investor compensation. – Within the suggested framework, public enforcement may still play a complementary role with regard to investor compensation, for instance by channeling the proceeds of public sanctions (e.g. disgorgements) to contribute to investor compensation, on the understanding however that the compensation is not the first and foremost objective of the enforcement action but a corollary instead.[1836] Alternative examples addressing the role of public investors with regard to investor compensation have been supplied by a French working group commissioned to suggest improvements to the legal framework as it currently applies to investor compensation. [1837] Various proposals made by the working group focus how the public supervisor may contribute to investor compensation, yet without turning the latter into its first and foremost objective. It has for instance been suggested that the supervisor could take into account whether the victims of the wrongdoing have been indemnified when determining the amount of the fine to be imposed. One step further, it is suggested to postpone the decision on the fine to allow the wrongdoer to indemnify the victim in the mean time. Another suggestion contends that the public enforcer may make settlement conditional upon indemnification of the victims. It is pointed out however that none of these proposals has been transposed into law yet.

[1835] Similar: WINSHIP, 'Fair Funds and the SEC's Compensation of Injured Investors', 1131. See for a similar conclusion with regard to EU jurisdictions also: (France) SPITZ, *La réparation*, 372-377. (Belgium) RAVELINGIEN, Privaatrechtelijke handhaving, 109. *But*: ROSE, 'Reforming Securities Litigation Reform', 1301, advocating a prerequisite screening of private actions based on Rule 10b-5 to allow the claim being brought before court and against whom. See also BLACK, 'Should the SEC', 337, on the suggestion (mostly advanced by the business community and political representatives) to restrict private enforcement in favor of public enforcement collecting investor compensation.

[1836] As disgorgement is more readily accepted and applied in criminal and administrative enforcement actions, rather than in the context of civil liability in various EU Member States, the public supervisor might indeed contribute to the deterrent effect of securities laws by using disgorgement in those cases where ill-gotten profits have been made and may even have motivated the occurrence of misreporting in the first place. For an overview of disgorgement of profits based on private law: T. HELMS, 'Disgorgement of profits', in J. BASEDOW, K.J. HOPT and R. ZIMMERMANN (eds.), *The Max Planck Encyclopedia of European Private Law*, Vol. I, Oxford, Oxford University Press, 2012, 485-489; with regard to disgorgement according to Belgian private law: M. KRUITHOF, 'De vordering tot voordeeloverdracht', *TPR* 2011, 13, arguing that the right to demand disgorgement as private litigant exists according to Belgian civil law, even though it is not broadly acknowledged.

[1837] For these proposals, consult the AMF report on the compensation of investor and depositor losses: 'Consultation publique sur le rapport du groupe de travail sur l'indemnisation des préjudices subis par les épargnants et les investisseurs', May 2011, available at: http://www.amf-france.org. See with regard to this report also: M. STORCK, 'Rapport relatif à l'indemnisation des préjudices subis par les épargnants et les investisseurs', *RD banc. fin.*, 2011, no. 2, Mars, comm. 71; and SPITZ, *La réparation*, 375-384, for a discussion of the role of the public enforcer in private enforcement proceedings.

E. Conclusion: what are the Member States and/or the EU to make of the private enforcement debate in the context of capital market disclosures?

541. This chapter advanced an alternative approach, i.e. the market model, to the concepts of causation and recoverable loss in the context of investor losses for misleading or incomplete market disclosures, with a particular focus on secondary market disclosure obligations. Contrary to the traditional transaction model that concentrates on the link between market disclosures and individual investment decisions, the market model is centered on the interaction between market disclosures and securities prices. More particularly, in line with reality, the market model does not assume that (retail) investors generally read, process and rely on particular secondary market disclosures in making investment decisions, but instead assumes that investors generally trust that they are trading against unmanipulated or otherwise undistorted prices (i.e. not affected by irregularities). As a result, causation no longer requires the investor to read or otherwise become aware of a particular secondary market disclosure that lead him to make a particular investment decision, but instead accepts that investment decisions are generally based on a range of elements that may include secondary market disclosures but is generally not limited to a single disclosure and that the real deception concerns the price against which the securities were traded. The concepts of causation and loss in the market based approach therefore concentrate on the price distortion caused by misleading or otherwise deficient information disseminated to the market. This approach facilitates claims for investors and allows for a more objective and verifiable assessment of causation and loss. The market model also allows, or may even require, the treatment of investor complaints on a collective basis. Although discussed from the perspective of secondary market information, the market model is relevant with regard to prospectus liability as well and proves compatible with most prospectus liability regimes, with the notable exception of Germany as a prospectus regime tailored to the transaction model has been anchored in statutory law and does not seem to allow room for alternative approaches.

From a policy perspective, this alternative model may contribute to investor compensation and simultaneously add to a deterrent and more effective overall enforcement system, provided that certain safeguards are taken into account. As demonstrated in the last section of this chapter, the US experience may be highly instructive as it shows that some concerns should be considered and anticipated in designing an appropriate liability regime applicable to misleading (secondary market) issuer disclosures. It was particularly demonstrated that under US law, the issuing company – and thus the shareholders – are generally held liable for secondary misreporting, rather than those who generally benefit from inflated stock prices, being directors and officers. Hence, it was argued that (part of) the solution involves aligning responsibility for misleading financial information with liability in order to enhance the deterrent effect of private enforcement. It was proposed to introduce deductibles as a complement to D&O insurance for liability following misreporting, which would allocate the risks and the burden of liability in a reasonable manner between issuers and individuals responsible for the emergence of the loss. Refinements depending on whether it concerns executive or non-executives directors, the standard of liability and the type of misconduct can all be taken into account to develop a better suited and more effective liability regime for secondary misreporting.[1838] In

[1838] See in this regard also: HANNICH, 'Quo vadis, Kapitalmarktinformationshaftung', 454.

case other third parties including experts, such as advisors, accountants or auditors, are also involved in misreporting scandals, their role should also be considered.[1839]

Considering the need to design a balanced and tailored liability regime also allows for the conclusion that traditional liability laws may be too rudimentary to offer an adequate solution.[1840] Specific (statutory) rules may be needed to design adequate liability regimes for secondary market disclosures. With regard to the design of such statutory liability regimes, experiences in other jurisdictions where specific statutory regimes have been developed with regard to deficient secondary market disclosures may serve as an example. For instance, the rather recent liability regimes introduced in (parts of) Canada may be instructive. In an effort to facilitate investor claims following misstatements to the market, Canadian legislative authorities developed new statutory rules. Yet learning from the US experience and apprehensive as to the unknown dimension such investor claims might take on, including implications for issuers and the attractiveness of listing in general, Canadian legislative authorities in Quebec and Ontario tried to reconcile the various interests at stake and created a tailored regime.[1841] With regard to imposing liability on individual corporate officers on the other hand, reference was made to the German legislative provisions on deductibles to prevent D&O insurance from neutralizing personal liability entirely.

Summarized, the development of a better suited liability model for violations of secondary market disclosure obligations requires a better understanding of the concepts of recoverable loss and (price) causation as set out in this chapter, but is not confined to these two requirements. For instance, insights in how insurance mechanisms, collective redress mechanisms and other techniques influence the effectiveness of the alternative model in terms of compensation and deterrence, reveal that the design of such model goes beyond the requirement of causation and loss.

[1839] HOPT, 'Die Haftung für Kapitalmarktinformationen', 110.

[1840] Supporting a similar conclusion with regard to German law: HANNICH, 'Quo vadis, Kapitalmarktinformationshaftung', 453.

[1841] See for instance s.138.1-s.138.14 Ontario Securities Act (enacted in 2005) The Ontario model has led the way as similar statutory regimes were adopted in other Canadian provinces, drawing on the Ontario model. See for instance the Quebec Bill 19, An Act to Amend the Securities Act and Other Legislative Provisions, 2007, available at http://www2.publicationsduquebec.gouv.qc.ca. See on these regimes also: P. PURI, 'Securities Litigation and Enforcement: The Canadian Perspective', 867, and particularly p. 999 ff.; FERRAN, 'US-style investor suits', 330 (with regard to the Ontario law); A. LAING and R. CARSON, 'Whither common law claims for secondary market misrepresentation', 103 (discussing Ontario law); R. CARELLI, 'Canada: prospectuses - secondary market', 62 (with regard to the Quebec law). In line with the considerations underlying the introduction of statutory regime in Canada, commentators in European jurisdictions also have argued in favor of the installment of capped damages for issuer liability. See for instance: SPITZ, *La réparation*, 83, paras. 122-123; DE JONG, *Schade door misleiding*, 229.

PART IV. CONCLUSIONS

542. This thesis examines whether and to what extent investors can claim damages for losses incurred following breaches of specific investor protection rules contained in EU capital market law and concentrated on the issues and difficulties in assessing the legal requirements of causation and loss. The focus particularly lies with the private enforcement of those investor protection rules aimed at empowering investors to assess the variety of investment products and strategies and enabling them to make well-informed investment decisions, with or without the professional assistance of financial service providers. Analyzing the difficulties investors encounter to recover losses following misleading disclosures to the market, incomplete or inaccurate financial advice or improper asset management, it was established that the notions 'causation' and 'recoverable loss' lack consistency and coherence. Throughout the thesis, distinct problems related to the interpretation and application of the legal requirements of causation and loss in these areas were highlighted and examined in detail, with the aim of formulating solutions to the evidential and/or conceptual problems investors encounter in seeking remedies for their alleged losses.

543. Setting out with the European legal framework, the underlying paradigms of investor protection regulation were examined and discussed as part of the European legal framework governing capital market integration. The analysis demonstrated that the provision of correct, timely and complete information is at the center of the EU investor protection system, regardless of whether it concerns issuer disclosure regulation, regulation on intermediaries (such as credit rating agencies and investment funds), and investment services regulation. Although the EU authorities have maintained their trust in the provision of information as one of the most important tools to ensure investor confidence and market transparency, concerns were raised over the course of time as to whether the mere provision of information is sufficient to protect investors and guarantee transparency about the products offered or traded in the markets. More particularly, observing the recurrent emergence of mis-selling litigation in several Member States, its scope and magnitude in the last decades, criticism and questions have surged asking whether and to what extent overreliance has been placed on the role disclosure and information obligations may play to enable investors to safely enter the financial markets. It was particularly felt that the information paradigm underlying the EU capital market laws may have exceeded its limits and failed to realize its goals adequately. Second, analyzing the current state of play of private and public enforcement, various policy reports have indicated that national enforcement of EU financial law is 'heterogeneous and weak' in some regards, while in the area of private enforcement, it was observed that a wide range of different liability rules exists, causing inconsistencies and uncertainty as to the level of investor protection across the Member States.[1842] Responding to these perceived shortcomings of the legislation, major reforms were carried out, though these reforms mostly focused on strengthening the role of public supervisors and, to a lesser extent,

[1842] On the different private liability regimes applicable to violations of EU capital market law, see for instance: ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, ESMA/2013/619, 30 May 2013, http://www.esma.europa.eu/, 41. With regard to the differences in public enforcement in the EU Member States and the need for streamlining: European Commission, Communication, Reinforcing sanctioning regimes in the financial sector, COM (2010) 716, December 8, 2010, available at: http://ec.europa.eu/internal_market, 16. With regard to the doubts on the effectiveness of prospectuses as a source of information towards retail investors: CSES, Study on the Impact of the Prospectus Regime on EU Financial Markets, 2008, June, available at http://ec.europa.eu/internal_market/securities/prospectus/index_en.htmp, 54. See on these concerns also Part I, Chapter I of this thesis.

product intervention, the latter moving away from the traditional disclosure approach. These tendencies were observed both on the national and the EU level.

544. In the second chapter, we built on these findings and examined at length if and to what extent the European legislation and courts have impacted the Member States national private laws, and the concepts of loss and causation in liability law in particular. Although an increased interest for private enforcement was observed in more recent EU capital market legislation and proposals, the influence of EU legislation has remained rather timid in the area of private enforcement of EU capital market law. An analysis of the division of power and competences of the EU legislator did not explain the absence of EU legislation in this field of law, notwithstanding the fact that the EU has been attributed broad, functional powers allowing interference in the national private laws if justified by the furtherance of the internal market and without overstepping the principles of subsidiarity and proportionality. The reluctance vis-à-vis EU law interfering in the private law sphere seems instead related to policy reasons and implications. More particularly, as it is believed that European rules impacting national private laws are likely to cause changes in the national legal doctrines not only in legal-technical terms, but also in terms of policy and national sovereignty, Member States have taken a reluctant stance, while the EU level moves cautiously to prevent unbalancing the political equilibrium. Balancing between the need to enact civil liability rules at the EU level and the sensitivity of the national Member States has resulted in a fragmented overall picture of EU capital market liability law. Whereas some directives provide for general obligations that redirect investors to the national civil liability laws for particular breaches of EU capital market law, other legal instruments remain completely silent, while more recent legislation has laid down further reaching requirements as to the degree of fault etc. Summarized, although an increased interest for private enforcement has been observed in recent legislative initiatives and proposals, the role private enforcement may play in enhancing investor protection and empowerment has remained in the background of the enforcement debate.

As a result of the piecemeal enactment of civil liability rules at the EU level, the effectiveness of the EU legal framework is highly dependent on the Member States' private laws and their application and interpretation by the national courts. Whereas rights are being created at the EU level, individual investors remain dependent on national laws and courts to enforce them. Yet, the EU level is not entirely left out in this regard, as the EU courts have taken up their role in supervising the uniform and streamlined interpretation and application of EU law by national courts. Faced with the fundamental question to what extent rights created at the EU level can be privately enforced by individuals in national courts, the Court of Justice of the EU developed an extensive set of principles and case-based doctrines to deal with the matter. The analysis of the EU case law showed that in some instances, the courts have moved faster than the political level, which was for instance clearly illustrated by the judgments that acknowledged the existence of private rights of action derived from EU legal texts that did not expressly provided for such rights. The EU courts' case law marked a watershed for the private enforcement of EU competition law and the interaction between the national and the EU level in this field of law, as it prompted the Commission to prepare legislative initiatives in this regard, which have resulted in a proposal for a new directive aimed at facilitating claims for violations of EU competition law to anchor the new state of play. In the field of capital market law, however, the influence of the EU courts has remained more modest, acknowledging the discretionary powers and prerogatives of the Member States in the area of private enforcement and liability law. As a result, it was concluded that even though the EU courts function as motors in a continuously evolving landscape, private enforcement of EU-originated capital market law has mostly remained within the Member States' province.

Building on this conclusion, our attention then turned to the national laws of the Member States, and more particularly to the private causes of action available to investors to claim remedies following breaches of mainly EU disclosure regulation and investment services regulation. Considering the national legal frameworks on which investors can rely to claim damages for violations of (often EU originated) capital market law, it was concluded that a mosaic of private causes of action based on general liability law, (pre)contractual and non-contractual law, as well as statutory causes of action, exists in several Member States. Specifically with regard to the statutory regimes, it was noted that these regimes were often enacted to facilitate investor claims. Alternatively, in some instances national statutory rules were enacted to comply with the obligation to provide for effective private remedies for breaches of particular EU legislative provisions. Overall, however, these specific legislative regimes were often found to be limited in scope, governing some aspects or conditions according to which liability is imposed, yet leaving other aspects – notably the concept of recoverable loss, causation and the assessment of damages – unaffected and therefore to be applied in accordance with the Member States' general liability laws. As a result, the requirements one must meet to obtain relief, the evidential rules that apply in a particular case, and the remedy available to redress the loss, depend on the applicable national law and, within the national frameworks, on the specific cause of action available to the investor.

Next, turning to the analysis of the requirements and concepts of causation and loss as they are applied in the Member States' national private laws, it was found that despite differences, the general concept underlying loss and causation is quite similar. Throughout the analysis, it became particularly clear that the concepts of causation and loss aim to remedy losses suffered by investors as a result of taking on investment risks they were not willing to take or that were unsuitable in the light of their investor profile and objectives, yet without creating a too lenient, investor-friendly system that would open the floodgates to investor litigation and enhance rent-seeking behavior in situations when investments record losses due to external and general market evolutions.

545. In the two subsequent parts of the thesis, the concepts of recoverable investment losses and causation were applied to two main subsets of investor litigation, being litigation following defective investment services and litigation following misleading market disclosures. In the light of the principles and framework set out in the first part of the thesis, insights on how to measure the loss and assess causation were developed, while the underlying principle of risk allocation in line with the responsibility of the parties was consistently borne in mind. Applied in the context of losses suffered (allegedly) due to defective investment services, it was found that the traditional reliance requirement, i.e. the requirement that the fault led the investor to make a particular investment decision, caused highly similar evidentiary difficulties relating to uncertain causation in several EU Member States. Comparing the techniques and solutions developed by courts and legislators, it was asserted that a shift in the evidential burden with regard to transaction causation offers a clear and unambiguous solution to the problem without impacting the question whether and to what extent recoverable loss has been suffered. Furthermore, the question as to the existence and calculation of the recoverable loss is to be answered in the light of a comparison with plausible alternative investments that would have been entered into absent the wrong. The question as to the recoverable loss and its calculation thus remains unaffected by the presumption of transaction causation. The examination regarding the reconstruction of plausible (yet hypothetical) alternative investments led to the conclusion that the construction of hypothetical reference portfolios in the light of investor profiles and objectives may offer a sound solution. The possibility to adjust and correct the scope of the recoverable loss in the light of the doctrines of contributory negligence, the duty to mitigate the loss and the determination of an appropriate reference date in line with the principle that liability risk and responsibility should be aligned concluded this second part of the thesis.

546. In the third and final part of this thesis, the concepts of causation and loss as employed in the context of market disclosures were examined. It was found that the traditional two-pronged concept of causation that applies in the context of investment services, encountered more serious problems when applied to market disclosures. More particularly, whereas the traditional model of investor reliance on disclosures, information and warnings proved workable in the context of investment services, the reliance model proved less successful to deal with investor losses incurred as a consequence of misleading statements to the market. Especially with regard to liability claims for violations of secondary market disclosure obligations, the model proved artificial and ill-suited. Drawing from insights from the scholarly literature in economic financial theory and legal comparative analysis focused on the US private enforcement system, an alternative model, i.e. the market model or market based approach, was developed. Contrary to the traditional transaction model, the market model focuses on the interaction between market prices and information, rather than between investment decisions and information. Different from the transaction model, the market model does not assume that (retail) investors read and rely on (a single) market disclosure document(s) to reach investment decisions. Instead, the market model assumes that investors trust that they are trading against ‘correct’ (i.e. not distorted by irregularities) prices, which implies that they are misled when securities prices are inflated or deflated as a result of violations of disclosure obligations that impacted the price. Hence, the requirement of reliance on a particular disclosure (or series of disclosures) is discarded under the market model, which facilitates investor litigation and allows for a more objective and verifiable assessment of causation and loss. The fact that the analysis of causation and loss is centered on the interaction between securities prices and wrongful information also allows for the treatment of investor complaints on a collective basis which facilitates the treatment of this kind of mass claims. Although the market model was predominantly discussed from the perspective of secondary market information, it may also bear relevance with regard to prospectus liability as it proves to be compatible with most prospectus liability regimes, with the notable exception of Germany. The German statutory prospectus liability regime has been tailored to the transaction model and has anchored the applicable remedy, i.e. rescission, in its legislative provisions. With regard to continuous disclosure obligations, however, we found that the German courts and scholarly literature have evolved towards a market model, an evolution that was also confirmed by the German Supreme Court.

547. In the light of these considerations, the US based market model may thus be instructive to policymakers seeking to promote and improve private enforcement mechanisms in the Member States. Yet, it was also pointed out that the US experience seems to indicate that the mere shift towards the market model will likely prove insufficient to obtain an effective and efficient liability system for secondary market disclosures. Although it was repeatedly stressed that investor litigation in the US takes place in a considerably different setting compared to the EU Member States, some of the problems that have arisen in the US should be taken into account by the EU Member States too when considering the design of a more effective liability system for secondary market misreporting. These concerns particularly relate to the finding that by means of insurance policies, and D&O insurance in particular, misrepresentation related-losses are entirely shifted to the issuing company, rather than being (partly) imposed those who generally directly benefit from inflated stock prices, being directors and officers. It was specifically demonstrated that directors and officers who bear responsibility for misstatements succeed in redirecting the liability risk entirely to the issuing company – and hence the shareholders – by means of D&O insurance which threatens the deterrent effect and overall effectiveness of private enforcement. Based on these findings, it was argued that (part of) the solution involves aligning responsibility for misleading secondary market misstatements with liability for these misstatements. Considering a range of suggestions and ideas to ensure a sufficiently effective liability mechanism, it was contended that partial insurance through capped deductibles as a complement to D&O insurance for liability following secondary market misreporting may prove particularly useful. The introduction of deductibles precludes managers, officers and directors from shifting their responsibility and liability risk in its entirety to the issuing company, yet it does not preclude directors and officers from being insured and prevents boundless, excessive liability on individuals by capping the deductibles. Furthermore, refinements in the application of deductibles can be arranged depending on whether it concerns executive or non-executives directors, while the standard of liability and the type of misconduct can also be taken into account to develop a better suited and more effective liability regime for secondary market misreporting.[1843] In case other third parties including experts, such as advisors, accountants or auditors, are involved in misreporting scandals, their role should also be considered.[1844]

548. Considering the need to design a balanced and tailored liability regime also allows for the conclusion that traditional liability laws may be too rudimentary to offer an adequate solution and that specific, legislative provisions are needed. Summarized, the development of a better suited liability model for violations of secondary market disclosure obligations requires a better understanding of the concepts of recoverable loss and (price) causation as set out in this chapter, but is not confined to these two requirements. Insights in how insurance mechanisms and collective redress mechanisms influence the effectiveness of the alternative model in terms of compensation and deterrence reveal that the design of such model goes beyond the requirement of causation and loss.

549. A final remark relates to the role that EU law may play in this debate. Throughout this thesis, it was demonstrated that notable differences exist in the Member States regarding the application of the legal requirements of causation and loss in the area of investor litigation by courts. If legislation aimed at harmonizing the interpretation and application of causation and loss in this area would be enacted at the EU level, such initiative would inevitably cause several Member States to amend their national laws. A recurring concern in this regard is the question how harmonized liability rules in the different areas of investor litigation are to be reconciled with longstanding and well-established national liability systems. Besides the mere legal implications, however, Member States might also be required to set aside national preferences and policy considerations that have shaped the national laws in this field of law. For example, various Member States expressly chose to confine the scope of statutory causes of action that facilitate investor claims relating to secondary market disclosures to claims addressing the issuer, thereby excluding claims directed against company directors, managers

[1843] See in this regard also: HANNICH, 'Quo vadis, Kapitalmarktinformationshaftung', 454.
[1844] HOPT, 'Die Haftung für Kapitalmarktinformationen', 110.

and third parties.[1845] Moreover, the most recent law reform relating to the design of the statutory liability regime for misstatements to the secondary market laid down in s.90A FSMA has been considered an illustration of the UK's preference for a limited role of private enforcement of the continuing disclosure obligations imposed upon issuers.[1846] For these reasons, legislative initiatives proposed at the EU level that promote (more harmonized) liability law as an enforcement tool for EU capital market law are bound to encounter opposition from the Member States as long as no consensus is reached on the role private enforcement ought to play in the EU financial markets. Hence, a policy debate on the desired private law effects of EU capital market law, its role in the light of investor protection and how it may support public enforcement mechanisms in disciplining the markets, is needed. It is repeated that so far, public supervision and enforcement mechanisms have drawn most attention in reforms taking place at the EU and at the national level, while the role of private enforcement in this debate seems somewhat neglected or overlooked. Yet, in the light of the findings set out throughout this thesis and the observations on the level of enforcement intensity in the European Member States in particular, the promotion of private enforcement within a more consistent and coherent legal framework – which may result from the aforementioned debate on the role of private enforcement – is a commendable strategy and may serve as a useful complement to public enforcement mechanisms.[1847]

[1845] For instance: the German statutory regime applicable to misleading ad hoc disclosure laid down §§37b, c WpHG only allows for claims addressing the issuing company. Similarly, s.90A FSMA excludes claims for misstatements to the secondary market that are not directed against issuers.

[1846] FERRAN, 'Are US-style investor suits coming to the UK', 315; DAVIES, 'Liability for misstatements to the market: Some reflections', 295.

[1847] See particularly: *supra* Part I, Chapter II, para. 58.

SAMENVATTING (SUMMARY IN DUTCH)

551. Dit proefschrift onderzoekt de vergoeding van beleggingsverliezen die geleden werden ingevolge inbreuken op beleggersbeschermende regels, met bijzondere aandacht voor de interpretatie en de toepassing van de aansprakelijkheidsvoorwaarden causaliteit en vergoedbare schade. Het onderzoek werd toegespitst op die beleggerschermende regels die een belegger in staat moeten stellen een goed geïnformeerde keuze te maken uit de gevarieerde en uitgebreide waaier aan aangeboden financiële producten, al dan niet met behulp van professionele financiële dienstverlening. Een toenemende aanwezigheid van *retail* beleggers die de markten al dan niet via (collectieve) beleggingsvehikels betraden, gekoppeld aan een toenemend belang van de financiële markten in het kader van de levensstandaard en pensioensplanning in het bijzonder.[1848] De stijgende aanwezigheid van *retail* beleggers op onze markten brengt de vraag met zich mee of het regelgevend kader met betrekking tot de aanbieding van beleggingsdiensten en –producten toereikend en voldoende aangepast is om deze beleggers op adequate wijze te beschermen. Een bijzondere uitdaging waaraan de (vaak op het Europese niveau geïnitieerde) beleggersbeschermende regelgeving het hoofd tracht te bieden, houdt verband met het aanbieden of adviseren van ongeschikte beleggingen of beleggingsstrategiën, het verstrekken van onvolledige of misleidende informatie ten aanzien van beleggers en/of markten, waardoor beleggers tot transacties en beleggingen overgaan waarvan zij de risico's niet (volledig) beseffen, of misleid zijn. Enkele markante voorbeelden van gevallen van *mis-selling* en misleidende beursinformatie waardoor beleggers op grote schaal schade leden en zich tot de hoven en rechtbanken wendden om vergoeding te bekomen zijn bijvoorbeeld de Nederlandse *effectenlease*-zaken en de *World Online* controverse, de Duitse *Neuer Markt*-schandalen, en de claims gericht tegen *Citibank* in België met betrekking tot de wijdverspreide distributie van gestructureerde *Lehman*-producten.

552. Om de bescherming van beleggers op markten te verzekeren en hun positie ten aanzien van professionele marktpartijen te versterken, voorziet het (Europese) kapitaalmarktenrecht in uitgebreide regelgeving gericht op de verstrekking van informatie aan beleggers in verband met producten die – al dan niet via beleggingsdiensten – worden aangeboden op de markten. Deze regelgeving omvat prudentiële regulering en vergunningsvereisten, maar ook onder meer transparantieregulering, gedragsregels en informatieverplichtingen gericht op het versterken van de beleggersbescherming op Europese financiële markten. Niettegenstaande het uitgebreide reguleringsstelsel, groeit echter het besef dat regulering op zich niet volstaat om een effectieve beleggersbescherming te garanderen. Verschillende rapporten, en niet in het minst de financiële crisis, illustreerden dat naast de nood aan regulering, ook een sterk handhavingsstelsel een noodzaak is om de naleving van de regels te garanderen. Naast ingrijpende hervormingen op het vlak van publiekrechtelijk toezicht en publiekrechtelijke handhaving, komt ook de mogelijke rol die privaatrechtelijke handhaving speelt, en nog meer zou kunnen spelen, steeds nadrukkelijker in beeld. Hoewel de rol van de privaatrechtelijke handhaving en de toepassing van het aansprakelijkheidsrecht in het kader van het kapitaalmarktenrecht in toenemende mate het onderwerp van academisch onderzoek vormen[1849], bleven de concepten

[1848] L. ZINGALES, 'The Future of Securities Regulation', 391-392; N. MOLONEY, *How to protect investors*, 3; N. MOLONEY, 'Regulating the Retail Markets', 375; J. WESTRUP, 'Independence and Accountability: Why Politics Matters', 127 ff.; IMF, Ageing and pension system reform: implications for financial markets and economic policies, G10, 2005, available at http://www.imf.org.

[1849] Zie in het bijzonder in dit verband: F. RAVELINGIEN, Privaatrechtelijke handhaving van informatieverplichtingen in het kapitaalmarktrecht, 2011, diss. (unpublished), 503.

causaliteit en vergoedbare schade tot dusver onderbelicht. Nochtans blijkt uit de beschikbare rechtspraak dat deze aansprakelijkheidsvoorwaarden vaak een moeilijk te nemen hindernis vormen voor beleggers die aanspraak maken op een vergoeding voor geleden verliezen. Daarnaast blijkt dat causaliteit en vergoedbare beleggersschade op een weinig consistente manier worden benaderd in de rechtspraak in verschillende jurisdicties. Dit proefschrift onderzoekt en toepassing van causaliteit en vergoedbare beleggersschade in de context van misleidende marktinformatie en gebrekkige beleggingsdienstverlening in een aantal EU lidstaten, met name België, Frankrijk, Duitsland, het Verenigd Koninkrijk en Nederland. Op basis van de analyse en bevindingen beoogt het onderzoek bij te dragen aan een meer consistente conceptualizering en toepassing deze concepten. Doorheen het proefschrift wordt gewezen op het belang van privaatrechtelijke handhaving met het oog op een effectieve beleggingsbeschermingen en worden aanbevelingen geformuleerd om de effectiviteit van de aansprakelijkheidsregels te optimalizeren.

553. Het proefschrift vangt aan met een kort overzicht van het Europese kapitaalmarktenrecht vanuit het perspectief van beleggerbeschermende maatregelen opgelegd aan de verschillende marktparticipanten, zoals emittenten, ratingagentschappen, beleggingsondernemingen en -instellingen. In een tweede hoofdstuk wordt onderzocht of en in welke mate de Europese kapitaalmarktregulering beleggers afdwingbare rechten toekent en de lidstaten verplicht in privaatrechtelijke handhaving te voorzien in geval van inbreuken op de Europese regels. Niet enkel de regelgeving, maar ook de rol van de rechtspraak van de Europese hoven wordt hiertoe geanalyseerd. Niettegenstaande de toenemende interesse op zowel het politieke niveau als de toenemende invloed van de Europese hoven, blijkt echter dat de privaatrechtelijke handhaving van het kapitaalmarktenrecht in grote mate een nationaalrechtelijke aangelegenheid is gebleven. Een derde hoofdstuk onderzocht om die reden de juridische grondslagen die benadeelde beleggers ter beschikking hebben op basis van het aansprakelijkheidsrecht van de eerder genoemde lidstaten. De interpretatie en toepassing van de voorwaarden van causaal verband en schade in deze nationale aansprakelijkheidsstelsels worden in detail toelicht en laten toe enkele algemene en gemeenschappelijke principes vast te stellen met betrekking tot de remediëring van beleggersverliezen.

Vervolgens wordt in een tweede deel van dit proefschrift onderzocht hoe de causaliteitsvoorwaarde en het concept vergoedbare schade door de nationale hoven en rechtbanken wordt toegepast in gevallen van gebrekkige beleggingsdienstverlening, met een bijzondere focus op inbreuken op de (MiFID) gedragsregels. In een eerste hoofdstuk wordt het causaliteitsvraagstuk in detail belicht, terwijl het tweede hoofdstuk het concept van beleggerschade en schadebegroting uitwerkt. In een derde deel wordt de analyze inzake causaliteit en schade tenslotte uitgevoerd met betrekking tot beleggingsverliezen geleden ingevolge deficiënte marktinformatie. Een eerste hoofdstuk verduidelijkt hoe de nationale wetgevers en de hoven en rechtbanken met schade en causaliteit omgaan op basis van de bestaande wetgeving en gerapporteerde rechtspraak. Het tweede en laatste hoofdstuk gaat vervolgens dieper in op een alternatieve benadering van causaliteit en schade in de context van gebrekkige en misleidende marktinformatie, gebaseerd op inzichten uit de financieel-economische literatuur en de Amerikaanse rechtspraak terzake. Dit alternatief model wordt onderzocht en geëvalueerd in het licht van de effectiviteit en mogelijke toepassing in een Europese context. Het proefschrift sluit af met een overzicht van de conclusies en aanbevelingen die uit het onderzoek naar voor kwamen.

ADDENDA

ADDENDUM I. SECTION 10(B) SEA 1934 (15 U. S. C. §78J)

Section 10(b) SEA 1934:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange:

To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Paragraph (1) of this subsection shall not apply to security futures products.

To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rules promulgated under subsection (b) that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities. Judicial precedents decided under section 17(a) of the Securities Act of 1933 and sections 9, 15, 16, 20, and 21A of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities.

ADDENDUM II. RULE 10B-5

Rule 10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

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