



HM TREASURY

# Extension of the statutory regime for issuer liability:

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a response to consultation

**March** 2010





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# 1

## Introduction and summary of proposals

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**1.1** The efficient working of capital markets is supported by the provision of timely and accurate information for market participants to analyse and drive the price formation process. This process operates both to protect investors and, more generally, to promote the efficient allocation of financial resources. Therefore, the question of to what extent companies, as issuers of securities, should be liable for inaccurate statements upon which investors rely to their detriment is an important one. Any liability regime must balance the interests of issuers and investors – providing appropriate incentives to make timely and accurate disclosures, as well as an appropriate right to recover losses without promoting speculative and unmeritorious litigation.

**1.2** The subject of the UK policy on issuer liability for disclosure arose during the implementation of the Transparency Directive into UK law. After consultation the Government sought Parliamentary approval for a statutory liability regime that was codified in section 90A of the Financial Services and Markets Act 2000 (FSMA), as introduced by section 1270 of the Companies Act 2006. It was acknowledged, however, that further adjustment to the regime might be required; therefore, in section 90B of FSMA, HM Treasury was given the power to amend, limit or extend the scope of the liability regime.

**1.3** In October 2006 the Government asked Professor Paul Davies QC, Cassel Professor of Commercial Law at the London School of Economics, to carry out an independent review in respect of damage or loss suffered as a consequence of inaccurate, false or misleading information disclosed by issuers or their management to the market, or the failure to disclose relevant information to the market promptly or at all.

**1.4** Professor Davies issued a first discussion paper in March 2007<sup>1</sup> and responses to that, coupled with extensive discussions with stakeholders, led him to publish his final set of proposals for changes to the law in June 2007<sup>2</sup>. The Government duly considered these and issued a further consultation based upon them in July 2008<sup>3</sup>, in which it set out proposals for the extension of the statutory regime for issuer liability, including draft Regulations.

**1.5** This consultation closed in October 2008 with the Government receiving a total of 25 responses. A full list of respondents is set out in Annex A. Respondents presented a range of views and opinions on the questions raised. This paper therefore sets out the Government's response to the consultation and explains how the responses have informed the Government's view in drafting the final Regulations - The Financial Services and Markets Act 2000 (Liability of Issuers) Regulations 2010.

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<sup>1</sup> *Liability for Misleading Statements to the Market: A Discussion Paper by Professor Paul Davies QC*, March 2007. Available at: [http://www.hm-treasury.gov.uk/d/davies\\_discussionpaper\\_260307.pdf](http://www.hm-treasury.gov.uk/d/davies_discussionpaper_260307.pdf)

<sup>2</sup> *Final Report of the Davies Review of Issuer Liability*, Professor Paul Davies QC, June 2007. Available at: [http://www.hm-treasury.gov.uk/d/davies\\_review\\_finalreport\\_040607.pdf](http://www.hm-treasury.gov.uk/d/davies_review_finalreport_040607.pdf)

<sup>3</sup> *Extension of the Statutory Regime for Issuer Liability*, HM Treasury, July 2008. Available at: [http://www.hm-treasury.gov.uk/d/issuerliability\\_170708.pdf](http://www.hm-treasury.gov.uk/d/issuerliability_170708.pdf)

1.6 The Government invited comments on the following list of proposals which are set out here along with the Government's decisions following the consultation process.

#### **Box 1.A: Summary of proposals**

1. To make no change to the current basis of liability (i.e., fraud).

**The Government has made no change to this proposal.**

2. That liability should attach in respect of securities admitted to trading on a UK regulated market or a UK multilateral trading facility.

**The Government has made no change to this proposal.**

3. That the statutory liability regime apply to:

- issuers of all securities admitted to trading on a UK regulated market or multilateral trading facility; and
- issuers of securities admitted to trading on an EEA regulated market or multilateral trading facility, where the UK is the home state for the issuer under the Transparency Directive or the issuer has its registered office in the UK.

**The Government has altered this proposal so that the statutory regime will be extended to cover all cases where securities are admitted to trading on a securities market where either the market concerned is situated or operating in the UK, or the UK is the issuer's home state.**

4. That the regime apply to:

- "transferable securities" as defined in section 102A(3) of FSMA;
- in the case of depositary receipts and other secondary securities giving a right to acquire or sell other transferable securities, the issuer liable to pay compensation shall be the issuer of the underlying securities, provided that the secondary securities concerned have been admitted to trading by or with its consent;
- for depositary receipts and other secondary securities admitted to trading without the consent of the issuer of the underlying securities, and for all other derivative instruments, the issuer of the depositary receipts, other secondary securities or derivative instruments shall be liable to pay compensation under the regime.

**The Government has made no change to this proposal, however it has clarified the wording in the Regulations so that they achieve the stated policy aim.**

5. That the scope of disclosure of the statutory regime should be:

- all information published by the issuer by means of a recognised information service;
- other information where the availability of that information has been announced by the issuer by means of a recognised information service; and
- a recognised information service for these purposes will include both RISs and information services used to disseminate information which is required to be published by the rules of an MTF.

The Government has altered this proposal to take account of the extension of the regime to cases where securities are admitted to trading on a securities market where either the market concerned is situated or operating in the UK, or the UK is the issuer's home state.

6. That the statutory regime should provide that the proposed immunity does not affect the rights of a holder of securities in his capacity as such.

The Government has altered the safe harbour provision and specifically preserved the following forms of liability: civil liability under section 90 (compensation for statements in listing particulars or prospectus); civil liability under rules made under section 954 of the Companies Act 2006 (compensation); civil liability for breach of contract; civil liability under the Misrepresentation Act 1967; civil liability arising from a person's having assumed responsibility, to a particular person for a particular purpose, for the accuracy or completeness of the information concerned; liability to a civil penalty; criminal liability.

7. That the issuer be liable, irrespective of whether the person claiming damages obtains the relevant information from a recognised information service, or other source, provided that the information was published on a recognised information service.

**The Government has made no change to this proposal.**

8. To extend the statutory regime to include liability where the issuer:

- acts dishonestly in delaying publication of the information;
- by the delay intends to enable a gain to be made or to cause loss to another or expose another to the risk of loss.

**The Government has made no change to this proposal.**

9. That liability should attach irrespective of whether the relevant transaction takes place on or off market.

**The Government has made no change to this proposal.**

10. To extend the regime to include sellers (but not holders) of securities.

**The Government has altered this proposal to extend the regime to include sellers and holders of securities.**

11. Not to extend the statutory liability regime to directors and advisers.

**The Government has made no change to this proposal.**

12. To make no changes to the statutory regime in respect of assessment of damages.

**The Government has made no change to this proposal.**

13. To consider further the issue of subordination of investors' claims.

**The Government has made no change to this proposal.**



# 2

## Basis of liability

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**2.1** One of the most fundamental questions surrounded what liability standard should be used in relation to misstatements. After considering the merits of three liability standards (fraud, negligence & gross negligence) Professor Davies recommended that fraud should be the basis of liability. The term fraud being used in the standard civil (as opposed to criminal) law sense: a statement whose maker knew it to be false or did not care whether it was true or false. Someone with a genuine belief in the truth of what was said would not be acting fraudulently, even if that belief were based on inadequate checking.

**2.2** The Government agreed with this and proposed to make no change to the current basis of liability – i.e. fraud.

### Respondents' views

**2.3** The vast majority of respondents were in favour of the Government making no change. They supported the arguments put forward in the consultation paper: that a negligence standard would likely lead to defensive and bland reporting; that gross negligence would likely be treated as akin to negligence and so also produce bland reporting; and, that the policing of negligence is best left to the Financial Services Authority's (FSA) rules and enforcement powers.

**2.4** Respondents who supported the fraud standard agreed that it maintained the right balance between enforcement by private investors and public enforcement by the FSA as the regulator.

**2.5** A small minority, however, argued that fraud was too high a standard of proof and that gross negligence should be adopted. These respondents argued that issuers have a duty to act with care and if there is reckless disregard in relation to this duty then they should be held liable.

### The Government's response

**2.6** The Government agrees with the majority of respondents and will make no change to fraud as being the basis of liability, as per the consultation proposal. The Government believes this strikes an appropriate balance between public and private enforcement. Negligent reporting will remain subject to the FSA's rules and the statutory regime will continue to play an important but subordinate role to such public enforcement by the FSA.



# 3

## Markets to which the regime is applicable

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**3.1** There were two issues considered: first, whether the regime should extend to Multilateral Trading Facilities (MTF)<sup>1</sup>, and secondly, what the geographical scope of the liability regime should be. These two issues will be addressed in turn with the Government's response to both thereafter.

### Extension to UK-Based multilateral trading facilities

**3.2** The statutory liability regime established in section 90A of FSMA applies to issuers of securities admitted to trading on UK regulated markets<sup>2</sup>; this was a necessary requirement of implementing the Transparency Directive into UK law. While there is no requirement to provide a statutory regime for issuers admitted to trading on other markets, it was felt that there was no reason why protection should not be afforded to those issuers and investors. Indeed Professor Davies' work showed that disclosures made by issuers on these markets are made in very similar circumstances, in response to the same investor needs and that issuers face similar incentives to make prompt and accurate disclosures.

**3.3** Consequently, the Government proposed that the liability regime should apply to all securities (i.e. securities issued by a UK or non-UK issuer) admitted to trading on a UK regulated market or a UK MTF.

### Respondents' views

**3.4** The majority of respondents supported this proposal. The view was that it was appropriate to apply a consistent liability regime to securities regardless of them being admitted to trading on different platforms. It was felt the focus should be on the information provided rather than the location of trading. Respondents therefore supported a uniform approach to issuer liability across markets, which it was felt would deliver certainty as to issuer responsibilities and investor rights. One respondent felt that through promoting certainty in this manner, the attraction of UK securities markets would be increased.

**3.5** Respondents concerned with the treatment of Swiss issuers argued that the statutory liability regime should not extend to Swiss issuers admitted to trading on the SWX Europe MTF. However, since the end of the consultation period the Swiss stock exchange has announced that they are seeking to repatriate trading of the Swiss stocks from London. Therefore, their specific construction of issuers' securities being listed in Switzerland but with a primary listing in the UK no longer exists. However they continued to question whether the UK should apply its rules on liability to securities, which, though admitted to trading on a UK market, are issued by an issuer established in another European Economic Area (EEA) state.

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<sup>1</sup> Multilateral Trading Facilities are defined in Article 4.1(15) of the Directive on Markets in Financial Instruments and defined in FSMA for the purposes of Part VI of the Act in section 102B(6).

<sup>2</sup> Defined in s.103 FSMA by reference to Article 4.1(14) of the Market in Financial Instruments Directive (2004/39/EC).

**3.6** Another respondent argued that under EU law it is the home state which regulates disclosures. Therefore, where the UK is not the home member state, it is the law of the EEA state which is the home member state that should be applied, even where the securities are traded on a regulated market in the UK. On this analysis it was argued that no provision should be made for application outside the UK, except to the extent that the Transparency Directive requires the UK to do so.

### **Extension to non-UK markets**

**3.7** A further aspect considered in the consultation paper was whether the liability regime should extend to UK issuers of securities admitted to trading on non-UK markets. In doing so the consultation paper discussed two options: to extend the statutory regime to all cases where English law is found to be the applicable law, or, to restrict its extension to a narrower group of markets.

**3.8** After setting out the arguments on each side the Government proposed that the statutory liability regime apply to:

- issuers of all securities admitted to trading on a UK regulated market or multilateral trading facility; and
- issuers of securities admitted to trading on an EEA market or multilateral trading facility, where the UK is the home state for the issuer under the Transparency Directive or the issuer has its registered office in the UK.

### **Respondents' views**

**3.9** Where respondents commented they were evenly split on this issue. Those respondents who agreed with the proposed extension to EEA markets acknowledged that the arguments put forward in the consultation paper were sound practical reasons for an expansion to EEA markets, but not to all cases where English law would apply. Some of these respondents also stated that in principle they would prefer an extension to all cases where English law was found to apply, but recognised the practical problems in so doing.

**3.10** An equal number of respondents felt that the proposal did not go far enough and that it should be extended to all cases where English law is found to be the applicable law. Respondents who argued for such an extension questioned the argument that to do so would create uncertainty - it was noted that the application of choice of law rules already creates a degree of unpredictability and the statutory regime would not alleviate this unpredictability.

**3.11** These respondents felt that it would not be desirable for the courts, using conflict of law rules, to be able to determine that English law was the applicable law, but then the statutory liability regime would not apply as a result of a geographical limit. Some respondents gave practical examples (for example, a UK investor in a UK company that has its sole listing on the US NASDAQ exchange) arguing that such an investor should not be completely excluded from the statutory liability regime simply because the company is listed outside the EEA.

**3.12** Some respondents also felt that the argument put forward in the consultation paper that the number of cases where a court would apply English law outside the UK and EEA is likely to be small was not a sufficient justification for excluding those investors. They stated that as a matter of principle a liability regime has to take into account both potentially common and uncommon cases.

**3.13** One respondent argued that under EU law the UK cannot seek to apply its law on market liability, on a home country basis, to disclosures by UK companies trading on facilities elsewhere in the EEA.

## The Government's response

**3.14** The Government has, after careful consideration, decided that in order to ensure the scope of the liability regime is clear and is applied on a uniform basis, subject to conflict of laws resolution, it will be extended to cover all cases where securities are admitted to trading on a securities market where either the market concerned is situated or operating in the UK, or the UK is the issuer's home state. This means that the proposed liability regime may in some cases be capable of applying extraterritorially, where for example, a claim relates to securities of a UK issuer admitted to trading on a US market. However in practice, the liability regime proposed would only give a right of compensation in cases where English law is found to be the applicable law of the forum in which a claim was brought. It will then fall to the courts, using the relevant conflict of laws provisions (e.g. Rome II Regulation<sup>3</sup>) to determine which law actually applies in a specific case.

**3.15** Although the number of cases where the courts would apply English law outside the UK and EEA is likely to be small and most overseas listings occur in jurisdictions with a well-developed securities regime, such as the US, the Government acknowledges that this should not be a reason to exclude such investors from the potential scope of the liability regime.

**3.16** The Government acknowledges the views put forward by the respondents concerned with the position of Swiss issuers who, at the time of responding, had their primary listing on an MTF in London. Although this specific construct no longer exists, the Government believes that should issuers wish to trade on a UK based market, they should be within the scope of the UK statutory liability regime.

**3.17** The Government agrees with the majority of respondents that it is important to ensure, as far as possible, that a consistent liability regime applies to all securities which are admitted to trading on UK markets. It does not consider that the Transparency Directive requires member states to exempt issuers whose securities are traded on UK markets from the UK regime on issuer liability if the UK is not the home member state of that issuer.

**3.18** The Government considers that the proposed application of the liability regime is consistent with EU law. Article 7 of the Transparency Directive is silent as to which Member State is to apply its laws on liability to issuers, and the principles of liability to be applied have not been harmonised under EU law. It is therefore inevitable that conflicts of law will arise where shares issued by an issuer based in one country are admitted to trading in another. EU law provides the tools to resolve them.

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<sup>3</sup> Regulation (EC) no 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II).



# 4

## Securities and issuers to which the regime is applicable

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**4.1** After assessing the related points of which category of securities should give rise to a right to compensation and who should be considered the issuer of the security, the Government proposed that the regime apply to:

- “transferable securities” as defined in section 102A(3) of FSMA;
- in the case of depositary receipts and other secondary securities giving a right to acquire or sell other transferable securities, the issuer liable to pay compensation shall be the issuer of the underlying securities, provided that the secondary securities concerned have been admitted to trading by or with its consent;
- for depositary receipts and other secondary securities admitted to trading without the consent of the issuer of the underlying securities, and for all other derivative instruments, the issuer of the depositary receipts, other secondary securities or derivative instruments shall be liable to pay compensation under the regime.

### Respondents’ views

**4.2** There was near unanimous support for the principles that underpinned these proposals. Therefore where respondents did make substantive comments they related primarily to two areas of wording in the draft Regulations.

**4.3** Firstly, a number of respondents expressed concern that defining an “acquisition or disposal of securities” to include acquisition or disposal of “any interest in securities”, would allow holders of certain derivative products (e.g. contracts for difference, options, futures) to bring a claim against the underlying issuer of the securities, whether or not the issuer had consented to the trading of those secondary securities. Respondents felt the effect of this wording would be to create uncertainty as to the pool of potential claimants that would be entitled to bring a claim against the underlying issuer. Furthermore, the potential value of such derivative holdings could be far greater than the market capitalisation of the underlying company issuing the securities.

**4.4** Secondly, whilst supporting the principle of liability attaching only where consent had been given, some respondents felt that the use of the word “consent” in the draft Regulations was too nebulous a term. It was argued that the Regulations should either use a more explicit term or the term should be defined more explicitly. Some respondents argued that the courts might discern that an issuer of securities who had knowledge of trading in secondary securities had given their implied consent to that trading and so be held liable.

**4.5** Finally, some respondents queried who would be liable to whom in cases of secondary securities.

## The Government's response

**4.6** The Government recognises that the term “consent” has created a degree of ambiguity as to its drafting aim. The Government is clear that simple knowledge of trading in secondary securities does not constitute implied consent by means of acquiescence and therefore potential liability to holders of those secondary securities.

**4.7** The Government has amended the Regulations to clarify this point. Section 2(a) of paragraph 1 of Schedule 1 now states that “an issuer of securities is not taken to have consented to the securities being admitted to trading on a securities market by reason only of having consented to their admission to trading on another market as a result of which they are admitted to trading on the first mentioned market.” The Regulations do however make clear that an issuer who accepts responsibility for the preparation of documents (such as a prospectus or listing particulars) for the admission of securities to a particular market is deemed to have consented to their trading on that market.

**4.8** The Government acknowledges that including acquisition or disposal of “any interest in securities” in the definition of an acquisition or disposal of securities would have extended the potential class of claimants to derivative holders to whom the issuer of the underlying securities should not, without giving the appropriate consent, be liable. The Government recognises that a person acquiring, for example, an option or a warrant in relation to certain securities does not only acquire the derivative instrument, but at the same time could be said to have acquired an interest in the underlying securities covered by the derivative instrument, within the meaning of paragraph 7(3) in the draft Regulations.

**4.9** The Government has therefore clarified the definition of the acquisition or disposal of securities by providing that it does not include the acquisition or disposal of a “depository receipt, derivative instrument or other financial instrument representing securities”; dealing in such instruments which give a right to acquire or sell other securities does not amount to the acquisition or disposal of the underlying securities.

**4.10** In relation to secondary securities the position is that if an issuer has not consented to the trading of secondary securities then they will not be liable to any holders of those securities. If, however, they have properly consented to the trading then they would potentially be liable to a holders of secondary securities if there had been a fraudulent misstatement and that statement had been relied upon in someone choosing to trade in those secondary securities. The issuer of secondary securities itself would only be liable to a holder if they themselves issue a fraudulent misstatement – they will not be liable for a fraudulent misstatement for which they were not responsible.

# 5

## Investors to which the regime is applicable

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**5.1** The statutory regime that Professor Davies reviewed applied only for the benefit of acquirers of shares. On the basis of Professor Davies' review and recommendation the Government proposed to extend the statutory regime to include sellers (but not holders) of securities.

### Respondents' views

**5.2** This issue dichotomised respondents between those who favoured the proposal to extend the regime to include sellers, but not holders, and those who favoured including both sellers and holders.

**5.3** Those who were in favour of not including holders argued that, whilst they could see there were arguments for their inclusion, a line had to be drawn and the proposal was the fairest way of achieving that. The view was that it would not be correct to allow a holder to bring a claim, which, if he were successful, would see damages being paid at the expense of other holders. They felt such holders would be better compensated through actions carried out by the company on their behalf.

**5.4** Those who favoured extending the regime to include holders argued that there was no principled justification for not doing so, and as they were also susceptible to harm, they deserved parity with buyers and sellers of securities as to the legal redress available. One respondent questioned the potential paradox whereby a holder of shares decides against selling his holding and instead buys further shares in reliance on a fraudulent statement; he would be able to bring a claim in respect of his new holding but not in respect of the shares he decided to retain.

**5.5** It was argued that to exclude holders would in fact lead to greater levels of uncertainty, as there would be different legal tests of liability for claims arising from the same information. This, it was argued, would likely lead to further efforts to extend the law of negligence through the court process.

**5.6** Regardless of whether respondents favoured extending the regime to include holders, they acknowledged there would, in practice, be very few cases where a continuing holder could successfully prove reliance and a resulting loss.

### The Government's response

**5.7** The Government, having weighed up all the points of view carefully, has decided to extend the statutory regime to include holders of securities as well as sellers. The potential to have two divergent regimes, one for sellers and purchases but another for holders would not be conducive to investor and issuer certainty. Furthermore, there is very little principled reason for seeking to bring sellers within the regime but to leave holders out.

**5.8** However, as the Regulations make clear, there must be reliance on information published by the issuer in deciding to continue holding securities. There is a clear difference between an active holder and a passive holder – the latter will not be entitled to bring an action as they would not be able to show reliance upon the statement in making their investment decision.

**5.9** To be able to bring an action a claimant would, for example, have to demonstrate that as a result of reliance on a fraudulent misstatement he instructed his broker to cancel a sell order and instead retained the holding of securities. A holder of securities who continued to hold without giving the matter any thought would be considered to have held those securities passively and thus not able to demonstrate the necessary reliance on the information to bring a claim.

# 6

## Disclosures subject to the regime

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### Information subject to the regime

**6.1** Under the Disclosure and Transparency Rules issuers admitted to UK regulated markets are required to use a Regulated Information Service (RIS). For issuers trading on an MTF, FSA rules do not specify the required channels through which disclosures must be made. Therefore, in order to provide issuers and investors with a consistent regime that covered the principal disclosures likely to affect the value of the securities the Government proposed that the disclosures subject to the statutory regime should be:

- all information published by the issuer by means of a recognised information service;
- other information where the availability of that information has been announced by the issuer by means of a recognised information service; and
- a recognised information service for these purposes will include both RISs and information services used to disseminate information which is required to be published by the rules of an MTF.

### Respondents' views

**6.2** Respondents made several points in relation to this proposal.

**6.3** The most common comment, which came from a number of respondents, related to the issue of "out of hours" disclosures as dealt with under the FSA's Disclosure and Transparency Rules (DTR). DTR 1.3.6 stipulates that if an issuer has to disclose information and an RIS is not open for business the company must distribute the information as soon as possible to: not less than two national newspapers in the UK, two newswire services operating in the UK, and, an RIS for release as soon as it opens. DTR 2.4.2 stipulates that if the rules of another regulated market or overseas stock exchange require a listed company to disclose inside information at a time when an RIS is not open for business it should disclose the information in accordance with DTR 1.3.6 at the same time as it is released to the public in the other jurisdiction. It was stated that the liability regime should align itself with the FSA's "out of hours" disclosure regime.

**6.4** Some respondents also queried whether the drafting of paragraph 2(1)(b) of the draft Regulations was too broad and unintentionally captured information contained in, for example, company circulars or on a company website, which they felt should not be within the scope of the statutory regime.

**6.5** A further point raised by respondents was that it was felt clarification was needed in respect of information, which, although it may not have been published by an RIS, its availability had been announced via an RIS.

**6.6** Some respondents stated that the Regulations should stipulate that liability under FSMA section 90A is without prejudice to liability under FSMA section 90 and vice versa. It was said that not doing so would allow a company to argue that information which had already been included in a prospectus, and therefore subject to the section 90 regime, would fall outside the scope of the section 90A regime.

**6.7** Some respondents stated that as there is a specific exclusion for prospectuses and listing particulars, which are governed by their own regime, there should be a similar exclusion for documents or announcements issued in the context of a takeover and subject to a regulatory regime administered by the Panel on Takeovers and Mergers. They argued that these documents are shareholding rather than market regarding.

**6.8** In relation to the question as to whether RISs would be overloaded with issuers seeking to bring announcements within the scope of the regime, those respondents who offered a view felt that this was not a likely outcome of the statutory regime.

## **The Government's response**

**6.9** The Government recognises that without taking account "out of hours disclosures" there will potentially be a short period where information, which is of the type intended to be caught by the statutory regime, falls outside it simply because the RIS was closed for business at the time the information had to be published. Therefore the Regulations have been amended accordingly to refer to "other means required or authorised to be used to communicate information to the market in question, or to the public, when a recognised information service is unavailable".

**6.10** In respect of treatment of prospectuses and takeover documents, the former are already subject to the FSMA section 90 regime which is why they have been excluded from the section 90A liability regime. In contrast takeover documents are already covered by the common law and therefore they should be included in the statutory regime to make the whole liability regime clear. To exclude takeover documents from the common law and statutory regimes would amount to a reduction in investors' rights.

**6.11** The Government's intention in respect of prospectuses is that if a person is able to bring a claim under section 90 of FSMA, they should not be able to bring a claim under the section 90A statutory regime. The draft Regulations gave effect to this by excluding information in listing particulars and prospectuses from the definition of "information to which this Schedule applies". However, it is acknowledged that this was unsatisfactory as it meant that a person who relied on information which was also published in a prospectus might be found to have lost their right of action under section 90A, even if they did not in fact have a right of action under section 90. The draft Regulations have therefore been revised so that information contained in listing particulars or a prospectus is potentially within the section 90A liability regime. However, an issuer will not be liable to pay compensation in respect of such information under section 90A if it is liable to pay compensation under section 90 (see paragraph 4 of the Schedule inserted by the Regulations).

**6.12** No similar provision is made in relation to the liability of an issuer for dishonest delay in publishing information under paragraph 5. Section 90 only gives a right to an action in respect of misleading statements or omissions, and not in relation to delay. In theory it would be possible for a claim to be brought under paragraph 5 for dishonest delay in relation to a delay in publishing information where the information in question was contained in a prospectus or listing particulars, though it is difficult to see how in practice there could be a dishonest delay in publishing such information. However, if a claimant is able to demonstrate that information should have been published earlier has been dishonestly delayed until the information is included in the prospectus or listing particulars then the Government believes they should be entitled to bring an action under the principles of dishonest delay.

**6.13** Where the availability of information has been announced by the issuer by means of a recognised information service, that information will be subject to the liability regime, as set out in the consultation paper. This is designed to ensure that an RIS announcement, which refers to documents such as annual accounts being made available, will bring the whole text of the

annual accounts within the scope of the liability regime. The Government accepts that this will significantly extend the scope of information which is subject to the liability regime. It will mean that references made to other information will bring that information within the scope of the regime. However, liability will only vest on an issuer where there is a fraudulent misstatement or omission in the information to which the RIS announcement refers, and a person discharging managerial responsibilities within the issuer knew of it (or was reckless as to whether the statement was untrue or misleading) and a claimant is able to demonstrate that he or she has suffered loss as a consequence of relying on that fraudulent misstatement or omission. Where all these tests are satisfied in relation to information whose availability has been announced by the issuer, there seems no reason in principle why the information should not be subject to the liability regime.

**6.14** Electing to extend the regime to cover all securities admitted to trading on a securities market where the UK is the issuer's home state, wherever the market in question is situated, raises the question of how we define information services for markets outside the EEA. As this regime potentially covers any market, anywhere in the world, the Government has clarified the meaning of recognised information service.

**6.15** A recognised information service is now defined to mean: in respect of an EEA securities market, "a service used for disseminated information in accordance with Article 21 of the Transparency Directive"; in respect of a non-EEA securities market, "a service used for dissemination of information which is equivalent to that which is required to be disclosed under the Transparency Directive"; or in relation to any market, "any other service used by issuers to disseminate information required to be disclosed by the rules of the market".

## **Source of information**

**6.16** The Government proposed that the issuer be liable, irrespective of whether the person claiming damages obtains the relevant information from a recognised information service, or other source, provided that the information was published on a recognised information service.

## **Respondents' views**

**6.17** There was majority support for this proposal – it was seen as a non-contentious issue.

**6.18** Some respondents queried how the liability regime would apply when there was not verbatim reporting of primary material through a secondary source.

## **The Government's response**

**6.19** The Government remains of this view and therefore liability will attach to statements put out on a recognised information service, even if a claimant does not obtain the information directly from the recognised information service.

**6.20** The rationale for liability arising even where an investor relies on information acquired from a secondary source was it was felt to not do so would impose too high an evidential burden on valid claims. Any statement put out through a recognised information service will be within the scope of the liability regime if that statement contains a fraudulent misstatement.

## **Shareholders' rights**

**6.21** Professor Davies' view was that the statutory regime for investors should not reduce shareholders rights against their companies to bring a claim for negligence. The Government agreed with this and proposed that the statutory regime should provide that the proposed immunity does not affect "the rights of a holder of securities in his capacity as such".

## Respondents' views

**6.22** Respondents agreed with the proposition that any rights shareholders have to bring a claim for negligence against their company should not be removed. However, a large number of respondents felt that the wording used in the draft Regulations did not achieve that stated aim and that it created uncertainty as to how the statutory regime would interact with the common law, in particular the *Caparo*<sup>1</sup> case.

**6.23** Specifically concerns were raised that the drafting of the Regulations excluded: contractual representations; non-contractual representations where there had been a voluntary assumption of responsibility; and, shareholders' rights to claim in negligence in relation to the governance and stewardship of the company.

**6.24** Though there was general agreement with the proposition that the rights of a shareholder in *Caparo* should be preserved, there was no consensus among respondents as to exactly what those rights were, or how they should be defined for the purposes of the regime. It was argued that the phrase "the rights of a holder of securities in his capacity as such" in fact undermined the aim of having a clear statutory regime.

## The Government's response

**6.25** The Government recognises that this is a complex but very important part of the statutory regime. The Government has, after careful thought and consideration, altered the safe harbour provision to take account of the views of respondents. The principle is that the issuer should not be subject to any other liability other than that provided for in paragraphs 3 and 5 of Schedule to the Regulations, except for the stated exceptions set out in paragraph 7.

**6.26** The Government has however amended the list of exceptions in paragraph 7(3) to the Schedule to state clearly that the following forms of liability are preserved:

- Civil liability under section 90 (compensation for statements in listing particulars or prospectus).
- Civil liability under rules made under section 954 of the Companies Act 2006.
- Civil liability for breach of contract.
- Civil liability under the Misrepresentation Act 1967.
- Civil liability arising from a person's having assumed responsibility, to a particular person for a particular purpose, for the accuracy or completeness of the information concerned.
- Liability to a civil penalty.
- Criminal liability.

**6.27** Paragraphs 7(3) and 7(4) of the Regulations still include liability to a civil penalty, criminal liability and the powers conferred under sections 382 and 384 (powers of the court to make a restitution order and of the Authority to require restitution), all of which were included in the draft Regulations and on which respondents did not make comment.

**6.28** The Government has now included an express provision in relation to civil liability under section 90 to clarify the relationship between paragraph 3(4) of the Schedule and paragraph 7(1). This ensures that a claim can be brought under section 90 for misleading information in

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<sup>1</sup> *Caparo Industries plc v Dickman* [1990] 1 All ER 568, HL

listing particulars and prospectuses despite paragraph 7(2). Similarly, civil liability which may arise if rules are made giving the Takeover Panel power to order a person to pay compensation is expressly preserved.

**6.29** The Government has elected to include an express provision in relation to contractual liability. This is to remove any doubt that where, for example, an issuer is in breach of any warranties given as to the accuracy of particular information, the issuer will remain liable for any compensation which may arise as a result of breach of contract. Similarly, where a person other than the issuer has warranted the accuracy of particular information to a third party, that person should not be able to avoid liability simply by relying on that provision of the Schedule which states that “a person other than the issuer is not subject to any liability, other than to the issuer, in respect of any such loss”.

**6.30** The Government has included an express provision in respect of civil liability under the Misrepresentation Act 1967. It was recognised that there was no reason to override the existing statutory protection offered by this Act.

**6.31** Finally the Government has included an express provision for civil liability arising from a person’s having assumed responsibility, to a particular person for a particular purpose, for the accuracy or completeness of the information concerned. This is intended to ensure that an issuer will remain liable for negligent misstatements where such liability would exist under the rule in *Caparo v Dickman*<sup>2</sup>, as subsequently developed by the courts.

**6.32** The objections respondents raised to the phrase “the rights of a holder of securities in his capacity as such” were that it was unclear and failed to clearly delimit shareholders’ *Caparo* rights. The objections illustrate the difficulty of defining the cases in which shareholders may have a right to compensation for economic loss arising from negligent misstatement in relation to the governance of the company.

**6.33** Under the test confirmed in *Caparo* and subsequent cases, liability arises in relation to negligent advice, where advice is given to a known recipient for a specific purpose of which the adviser is aware, and the recipient has relied on the advice, acting on it to his detriment. Expressed in other words, the defendant will be liable for negligent misstatements causing economic loss where the defendant has assumed responsibility to the claimant for the accuracy of the information given to the defendant, who acted on that information and suffered loss as a result. The revised provision in paragraph 7(3)(a)(iv) of the Schedule to the Regulations preserves this test.

**6.34** The new test excludes the possibility of shareholders asserting that companies have a wider duty of care for misstatements in relation to governance rights that might cause economic loss (except of course where there is an assumption of responsibility falling within the scope of our provision). No such duty has been established in case law. The Government is not aware of any material circumstances in which such a duty would be appropriate, nor were any examples provided during consultation.

**6.35** Respondents were unable to offer alternative wording which would leave open the possibility of shareholders asserting that such a wider duty of care exists in law, without creating ambiguity as to the meaning and intended effect. The Government does not believe it is practicable to draft an exception in relation to undefined hypothetical rights that the courts might or might not subsequently recognise. A general exception referring to rights of a shareholder in his capacity as such or similar wording is not capable of being clearly defined without creating doubt as to the scope and effect of the statutory regime. It would be likely to

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<sup>2</sup> Ibid.

result in significant tangential litigation seeking to define exactly how the exception should be applied.

**6.36** In respect of documents such as circulars specifically addressed to shareholders for, inter alia, governance purposes, the Government believes that any claims brought by shareholders in relation to negligent misstatement giving rise to economic loss would depend on the test set out in paragraph 6.33 (as indeed was the approach taken in two recent cases), which is preserved under the new regime.

**6.37** Accordingly, the Government believes that any potential for identifying undefined rights which this change of wording might extinguish is outweighed by the need to avoid uncertainty in the scope of the regime, which would leave open the potential for unmeritorious litigation and might expose issuers to the risk of liability for negligent misstatement in circumstances where this was not intended.

# 7

## Liability for dishonest delay

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**7.1** The Government's view in seeking to create a liability for dishonest delay is to reinforce the incentives for prompt disclosures, provided that the scope of the liability is precisely drawn to ensure that legitimate delay is not penalised and defensive behaviour on the part of issuers is not promoted. Clearly it is recognised that there will be situations where disclosure of information is delayed for good reason (for example to check facts before publication).

**7.2** Consequently, the Government proposed to extend the statutory regime to include liability where the issuer:

- acts dishonestly in delaying publication of the information; and
- by the delay intends to enable a gain to be made or to cause loss to another or expose another to the risk of loss.

### Respondents' views

**7.3** This was a finely balanced issue and respondents presented a range of views.

**7.4** A number of respondents were not in favour of the creation of a liability for dishonest delay. Some felt that the existing FSA powers, especially the DTR rules, already covered this area sufficiently and that these represented the most effective way of punishing delay. Respondents therefore questioned whether, with the FSA's current powers, a statutory liability for dishonest disclosure would in fact provide a more effective incentive for prompt disclosure. One respondent also argued that where serious and intentional dishonesty takes place sanctions against individual directors could be brought under the Fraud Act.

**7.5** Some respondents felt that such a regime would increase the risk of speculative litigation and unnecessary settlement. However, others argued that the high evidential burden placed upon claimants would act as a disincentive to speculative litigation. Indeed one respondent who supported liability for dishonest delay felt that the dual test laid down was such a high burden on claimants that it would be practically impossible to surmount.

**7.6** Some respondents argued that although they supported the creation of a liability for dishonest delay, it should be restricted to information that is subject to a statutory requirement to publish.

**7.7** Some respondents argued that where a delay was deliberately caused by a director concealing information from the relevant company – the company as a whole not being aware of the dishonesty – liability should be excluded.

**7.8** A number of respondents questioned whether the drafting was sufficiently tight to ensure the stated aim of ensuring that that legitimate delay is not penalised and defensive behaviour on the part of issuers is not promoted. Furthermore, some respondents stated that there was a possibility that by not stipulating the test of dishonesty to be applied, the court would apply the civil test of dishonesty rather than the criminal test, as these Regulations impose a civil liability.

## The Government's response

**7.9** The Government recognises that this remains a finely balanced issue; however, is still of the opinion that such a liability is appropriate to reinforce the incentive to disclose relevant information promptly.

**7.10** As stated in the consultation document it is important that the scope of liability can be precisely drawn to ensure that legitimate delay is not penalised and defensive behaviour on the part of issuers is not promoted. Therefore the question of how the liability regime will interact with the FSA's rules is an important one. The fact that a delay is not regarded as dishonest would not mean that there was no breach of the FSA's rules. Similarly, not all breaches of the FSA's rules would entail the imposition of statutory liability. The FSA's rules are intended to have a wider reach than the statutory liability regime by covering delay arising from negligence and recklessness.

**7.11** The Government acknowledges that the argument that liability for dishonest delay should only attach to statements that are required to be made has some merit in terms of reducing the risk of opportunistic litigation. However, in order to be successful a claimant would have to demonstrate that a particular statement should have been made at a previous point in time and in fact wasn't, and the act of so doing, was as a result of dishonest behaviour intended to enable a gain to be made or to cause loss to another or expose another to the risk of loss. This is a very high evidential hurdle that claimants will have to satisfy and thus reduces the possibility of opportunistic litigation.

**7.12** The Government is not convinced by the argument that liability should be excluded for cases where a board member is concealing information from the board. To do so would create serious evidential problems. Moreover, companies should have their own internal controls and checks that prevent the possibility of this occurring.

**7.13** The Government acknowledges that there is a risk that the courts would adopt the civil, as opposed to criminal, test for dishonesty. Therefore to prevent this, the Regulations expressly define dishonesty using the criminal test so that a person will be "dishonest" in respect of a delay where that person's conduct would be regarded as dishonest by those who regularly trade in the markets in question, and, in addition, the person concerned was aware that their conduct would be regarded as dishonest.

# 8

## Other issues

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### Trading off-market

**8.1** The Government proposed that liability should attach irrespective of whether the relevant transaction takes place on or off market.

### Respondents' views

**8.2** A vast majority of respondents supported this proposal. One respondent, however, argued that the liability for off market transactions should be limited to situations where both the seller and purchaser are based in the UK.

### The Government's response

**8.3** The Government does not propose to change this proposal and therefore liability will attach irrespective of whether the transaction takes place on or off market.

**8.4** To limit this to situations where both the seller and purchaser are based in the UK would run contrary to the principles underpinning the rest of the liability regime and would impose an unnecessary restriction.

### Application to directors and advisers

**8.5** The common law applies to directors and advisers who make statements on behalf of the company. However the statutory regime, as established, applies only to issuers and excludes liability on the part of others. The Government therefore proposed not to extend the statutory regime to include directors and advisers.

### Respondents' views

**8.6** The vast majority of respondents supported this proposal.

**8.7** A small minority of respondents however argued that the desire to produce a cleaner legislative package should not necessarily preclude this area being considered further. One respondent argued that the statutory regime should continue to mirror the common law position whereby directors and advisers are liable for the statements they make on behalf of the company.

### The Government's response

**8.8** The Government does not feel it would be beneficial to extend the liability regime to cover directors and advisors.

**8.9** Directors remain liable to their company in negligence and liable to be sued by the company, or by a shareholder on behalf of the company through the new derivative action procedure of the Companies Act 2006. Furthermore, they continue to be exposed to the FSA's penalty regime if knowingly concerned in the contravention by the issuer (under section 91(2) of FSMA). The Government believes that these provisions are sufficient.

## Measure of damages

**8.10** Professor Davies felt that it would not be desirable to tie the courts' hands by formulating rules with respect to damages. The Government agreed with this and proposed to make no changes to the statutory regime in respect of assessment of damages – it would be a matter for the courts to decide.

## Respondents' views

**8.11** There was wide support for this proposal among respondents who felt that it was right that the courts should decide the quantum of any damages.

**8.12** One respondent however stated that the best place to deal with the issue of damages is in the legislation itself and that this should form part of the statutory regime.

## The Government's response

**8.13** The Government agrees with the majority of respondents that it would not be desirable to tie the courts' hands through laying out in legislation the assessment of damages. Therefore the Government will not make any changes to the statutory regime in respect of assessment of damages.

## Subordination of investor claims

**8.14** The current position under the statutory regime is that in the event of an issuer's insolvency, investors' claims rank alongside other unsecured creditors and ahead of those of shareholders. Davies stated that this was an area which needed further consideration; however, there was no reason to delay other changes while this is resolved. Therefore the Government proposed to consider further the issue of subordination of investors' claims.

## Respondents' views

**8.15** Where respondents made comment, there was agreement that this is an area which needs further consideration. Some respondents also proffered a view on whether investors' claims should be subordinated with a roughly equal split between those who felt they should be subordinated and those who felt they should rank equally with unsecured creditors.

**8.16** One respondent felt that the area was fundamental to the liability regime and that it was unsatisfactory that the statutory regime would be introduced without this area being fully dealt with.

## The Government's response

**8.17** The Government agrees that this is an important area and one that needs further consideration in conjunction with the Insolvency Service. However, the Government does not feel that the liability regime should be delayed until this area is fully resolved.



# Respondents to the consultation

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Ashurst  
Association of British Insurers  
Barclays Bank  
BP  
Clifford Chance  
Confederation of British Industry  
Deloitte  
Financial Markets Law Committee  
GC100 (Association of General Counsel and Company Secretaries of the FTSE 100)  
HBOS  
Herbert Smith  
Hermes Fund Management Ltd  
International Capital Markets Association Limited & Securities Industry and Financial Markets Association  
Investment Management Association  
London Stock Exchange  
Mr Philip Bovey  
Norton Rose  
Preger Dreifuss  
Prudential  
Swiss Exchange  
SwissHoldings  
The Association of Investment Companies  
The Institute for Chartered Accountants in England and Wales  
The Law Society's Company Law Committee  
The Quoted Companies Alliance

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