

Review of Issuer Liability

Questions on Foreign Markets

Liability arising from inaccurate statements made to the market

Assessment regarding **FRANCE**

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1. This study is primarily concerned with civil liability and, within that, liability in damages (but see point 9 below). Is there a particularity in the French legal system concerning the award of damages?

One thing that must be stressed is that civil liability is almost always linked with criminal prosecution in France because inaccurate statements constitute most of the time criminal offences. What is called a civil action is a suit or action in damages brought by a victim of a criminal offence before criminal courts¹: we only call it a civil action if it is linked to the criminal prosecution of the offence the defendant would have committed (i.e. when the criminal court will hear the case in damages and take a decision itself, without referring to a civil court/judge). Whereas the criminal prosecution (called in French the public action) is legally based on a provision of the French Penal Code, the civil action is based on the French Civil code and the principals of tortuous liability.

The civil action can either be the starting point of the criminal prosecution (cf. question 9b) or it can be launched after the criminal investigation has started; either way there is a *constitution de partie civile* (i.e. the victim becomes a party to the prosecution and asks for damages, were the defendant found guilty of the offences). In order for this *constitution de partie civile* to be accepted by the court, there must be a sufficient causality link between the offence and the alleged loss.

The civil action has two main advantages: first, all the collection of evidence relies only on the judge who will use his inquisitorial powers. Second, the action in damages does not need to state a defendant, since it will be the prosecutor's role to decide whom to prosecute (the company and/or the directors).

It is also important to stress that if a criminal prosecution has been launched concerning some facts, a civil judge (i.e. a judge having to hear the proceedings for the same fact but not within the civil action) will have to stay his proceedings until the criminal prosecution has come to an end before holding a decision relevant to the civil case.

2. Does the law in principle impose liability for market statements?

a. If yes, which rule of law imposes liability?

Yes, the law does impose liability for market statements but not by using a specific rule: if a statement constitutes an error and causes a prejudice, damages may be claimed on the grounds of article 1382 of the French Civil Code which reads "Any act whatever of man, which causes damage to another, obliges the one by whose fault it occurred, to compensate it". It can be inferred from this

¹ Article 2 of the French Penal Proceedings Code

general principle that liability for market statements exists or at least cannot be excluded if the statement causes damage.

To construe liability for market statements, courts will use this general tort rule and there is no specific tort rule applicable in this case, except one concerning directors. Article L. 225-251 of the French Commerce Code states that directors are liable towards the company or third parties (i.e. shareholders and investors) if they violate legal or regulatory provisions on companies (i.e. among others the Commerce Code, the Monetary and Financial Code and the AMF² regulations): market statements which are wrong, inexact or misleading most surely violate legal provisions (criminal law and/or AMF regulations) and therefore can lead to liability³.

b. Do people litigate using Civil Code principles in practice? Do they represent a real threat of liability?

Yes, people litigate on them because there are very few specific principles and statute regarding civil liability: in French law, tort is governed by 4 articles in the Civil Code (articles 1382 to 1386) and all litigation and case law derives from these articles. These are the articles used in case of a civil action piggybacking on a criminal prosecution to establish civil liability.

They represent a real threat of liability because all successful civil trials (including the Sidel case) are decided upon these principles.

The fact that these principles are very general also informs us on why there was no need for a specific statutory regime such as the one for ad hoc statements in Germany.

c. Have the Market Abuse and Transparency directives been implemented into French law? Do they have an effect on the liability of companies or directors for statements made to the market?

The Market Abuse directive was implemented into French law by an act of July 20, 2005 (*Loi portant diverses dispositions d'adaptation au droit communautaire dans le domaine des marchés financiers*). This act does not directly concern our topic; it mostly concerns insider dealing and the protection of whistle-blowers.

The Transparency directive was implemented into French law by an act of July 26, 2005 (*Loi pour la confiance et la modernisation de l'économie*). Part of the directive still needs to be

² See question 9 for a presentation of the AMF (*Autorité des Marchés Financiers*).

³ "Can" because directors are liable to third parties in specific cases, see question 6.

implemented, and this will be done through the French FSA General Regulation (which has legal force on all public companies). The only liability that this imposes on directors and companies is the one occurring when the account statements publicity obligations have not been met.

One of the reasons why the implementation of these directives does not require the enactment of a new specific form of liability seems to be, according to some authors, because French civil and criminal law already acknowledges civil and criminal liability accordingly.

d. Are there specific rules applicable to prospectus liability?

No, prospectus liability is based on the same offences and tort law as misstatement liability.

3. If so, does it distinguish between different types of statement:

a. e.g. statements made in periodic reports (yearly or half-yearly or others), statements required to be made to the market, for example, about significant events affecting the company, voluntary statements made by companies to the market?

No, there is no distinction on the different types of statement: liability can derive from any form of statement as long as it causes damage. It does not matter whether the statement is in the form of accounting statements or any other form of public communication.

b. E.g. between voluntary statements and involuntary statements. Where do you draw the line between a voluntary and an involuntary statement?

If we try to answer this question from the criminal liability point of view, as long as the person making the statement (voluntarily or not) knows that the information is false or misleading, the mere fact of spreading this information is a criminal offence (this is because the offender plays an active role in the offence). Therefore, although this has to be distinguished for each offence, intention is not always required for the statement to lead to liability.

From a purely civil liability standpoint, intention is not required by article 1382 of the French Civil Code, and therefore negligence will be sufficient to get damages before a civil court. But since the inaccurate statements cases are generally linked with criminal proceedings, and considering the fact that the criminal court decision (which requires intention) is binding on the civil courts, it will be difficult to obtain damages on the basis of negligence even before the civil courts (although not impossible).

4. What is the basis for such liability: negligence, intention, recklessness, strict?

a. What are the conditions to be met for a liability to be established and for damages to be awarded?

Three things must be proven for such a liability to occur: a faulty action (i.e. the market statement or disclosure), prejudice and causation. There is no requirement for negligence as long as the action was wrong and causes prejudice which is linked to the act. The problem is that the proof of these 3 elements relies exclusively on the claimants and this proof (especially the proof the action was faulty) is difficult to establish.

A way to prove the act was wrong is to have the court establish that the mentioned action constituted a criminal offence. If the civil action is brought within a criminal offence, then all the evidence has to be looked for by the prosecution service and not by the claimant (which saves him a considerable amount of money).

b. What criminal offences are relevant in the case of misstatements to the market?

Usually, the offence for which directors and/or companies are prosecuted is called *communication ou de diffusion d'informations fausses ou trompeuses* (communication or transmission of wrong or misleading information to the market which appears in article L. 465-2 of the French Monetary and Financial Code, and in COB Regulation 98-07).

The exact text of the offence is the following: “*Est puni des peines prévues au premier alinéa de l'article L. 465-1 le fait, pour toute personne, de répandre dans le public par des voies et moyens quelconques des informations fausses ou trompeuses sur les perspectives ou la situation d'un émetteur dont les titres sont négociés sur un marché réglementé ou sur les perspectives d'évolution d'un instrument financier admis sur un marché réglementé, de nature à agir sur les cours.*”

This concerns the communication or publication of false or misleading information regarding the prospects of a public company to the public (e.g. through articles, press releases, Internet or through a communication made to financial analysts, but communicating the information to the board is not considered as communicating to the public) by any means.

The offence is not restricted to a certain number of potential wrongdoers: any person spreading such misleading or false information may be prosecuted (directors, auditors, shareholders, journalists, laymen or the issuer company itself).

This only concerns the case where the person communicated the inaccurate statement with full knowledge that the information was wrong or misleading. Therefore, mere negligence does not constitute the offence. For example, if the director sent the wrong press release negligently, the offence will not have been committed.

It is irrelevant whether or not the inaccurate statement made to the market has had an impact on the stock exchange: as long as the false statement, which could have had an impact, was made, the offence is committed and can be prosecuted. Therefore, recklessness can be prosecuted: e.g., if the director was not sure that the false statement could have an effect on the market but disclosed it anyway, he may be prosecuted. There is no precise test to see if a piece of information could have had an impact.

The so-called false or misleading information must not be mere rumours according to case law; this is contrary to article 1, 2, c of the Market Abuse directive which adds rumours to the list of possible ways of spreading the false information. Since the text of the offence was not changed when the directive was implemented into French law, it is fairly likely that the court's construction of the criminal provision will change following this directive.

With the current state of the case law regarding this offence, it is not clear whether the claimant/victim has to prove that he or she bought or sold the shares only by relying on the inexact, wrong or misleading information, although his knowledge of the public disclosure has to be established in some way for damages to be awarded.

Out of the list of criminal offences related to accounting, only one seems relevant here: the presentation or publication of unfaithful annual accounting statements (*presentation ou publication de comptes annuels infideles*). The offence concerns cases where the directors published the statements knowing that there was a mistake in the preparation of the statements (such as a method for valuing stock chosen especially to increase the company's credit). In a way, this offence corresponds to the publication of misleading information in accounting matters.

Since the civil action usually takes place within the prosecution, damages will be awarded if the defendant(s) is proven guilty of the offence and the victim can prove the prejudice incurred by the disclosure.

5. What is the range of claimants? (For example, only those who buy shares or also those who sell or hold shares).

Case law from the Cour de cassation's criminal division (much of these cases are criminal cases with a civil action joined to it, and therefore is heard as part of criminal cases) shows that such liability only occurs when an investor buys or sells shares (Flammarion and Pfeiffer cases), but not when an investor holds shares.

Although it has to be stressed that the Paris Court of Appeal (considered as the most senior and influential court of appeal in France) has admitted in certain cases that investors who hold shares while their value plummet due to market misstatements were entitled to damages. This was upheld by the *Tribunal de Grande Instance de Paris* in the very recent Sidel case. But this is more difficult to prove because the loss incurred is less certain than if the claimant had bought or sold shares.

6. What is the range of defendants (company only, directors, advisers)

Companies will most of the time be liable for such disclosures or statements. The issuer company can be liable on the basis of Article 1382 (liability for personal acts) or on the basis of Article 1384(5): in the latter case, the company is deemed liable for the wrongful acts committed by its employees (i.e. directors). Therefore, even though the director will not always be found liable (see below), the company's responsibility may be sought if the director was acting within its usual powers under the company's authority. This form of liability will of course be of no use if the company has been wound-up, and this is why the limitation to director's liability is so ill perceived in France.

Directors will be personally liable to third parties (i.e. shareholders and investors asking for damages) only when it has been proven that the act they have committed is so serious that it cannot be linked to their duties as director, i.e. the wrongful act must be "severable" from what the director's duties entail for the director to be liable towards shareholders (Cour de cassation, civil division, 20/05/2003). This has not changed since the implementation of the Transparency directive into French law. In effect, the Cour de cassation authority prevents directors from being personally liable to third parties in most cases.

It must be stressed that the Criminal division has a different view on this matter: "severability" is not a requirement for the director to be considered personally liable. Therefore, directors may be found liable for market disclosures if the civil action is brought along criminal prosecution. This is of course only the case if the director is personally accused and has himself committed the criminal offence in question. Since the criminal prosecution has a binding effect on the civil procedure related, if the claim in damages is brought through a civil action, there will be no need for "severability" for the claim to be successful.

Finally, it must also be noted that auditors and external advisors can also be prosecuted or sued and therefore become defendants in either criminal prosecutions or/and civil claims. Especially, there is no restriction on the range of defendants in the mentioned criminal offences and an auditor for example could easily have published knowingly wrong information about a company's prospects therefore committing a criminal offence. In theory, investment banks (having introduced the company's stock on the market) could very well be sued: in practice, the claimant will have to show that it was not sufficiently diligent and no case has been brought yet to the courts on that matter.

7. Does such litigation actually occur? If so, in what sorts of circumstances, brought by what sorts of claimants and against whom?

Yes, such litigation does occur (almost exclusively along with criminal prosecution) but damages are rarely awarded by courts. One of the biggest problems is the very restricted possibility of a group or class action: because of this and the costs involved by going to court, investors rarely sue and therefore there is little litigation on this matter with small investors as claimants.

One of the recent examples is the Flammarion case (a purely civil case before the Paris Court of Appeal, 26/10/2003): shareholders had sold their shares right after the publication of half-yearly statements which showed the company was not in good shape but right before the company was sold for a premium. This was considered as misleading information (more precisely as the half-yearly statement did not show a bright outlook for the share value in the short term, which was not true considering the sale agreement being drafted) and the shareholders were awarded damages since they could have sold their shares at a higher price right after the sale announcement. In this case, only the company was found liable (the president was not since the communication of the misleading information was not deemed as "severable" from the president's functions and powers). The information was misleading because it misled the shareholders on the short term share value prospects. This case was also peculiar because the court awarded damages for the loss of an opportunity, i.e. for the loss of the opportunity of selling the shares at a higher price. The award of damages for loss of a chance or opportunity exists under French law but is rarely applied to securities tort litigation.

8. Collective private litigation

- a. Is any form of collective private litigation facilitated by the legal system (for example, class actions)?**

Regular class action has not been introduced yet in our legislation. A bill has been introduced before Parliament regarding class actions, but it only concerns consumer class actions. The bill itself is called the Consumer Protection Bill. Considering the presidential election ahead, it is highly unlikely that a class action system be introduced in French law anytime soon (even the introduction of consumer class action appears in jeopardy for the moment).

What we have for the moment is a limited form of class action through associations of investors. Such groups of investors can sue for damages (they cannot launch criminal prosecution) if their members hold at least 5 % of the company's share capital. They can even advertise their services through the press upon authorisation of the president of the Commerce Tribunal.

b. For what reasons are authors and investors looking forward to the possibility of class actions?

The first reason is the role of the securities market regulator. The general public and many authors consider that the securities market regulator takes care of all the prosecution regarding market misstatements and that therefore there is no possibility or no room for civil actions and criminal prosecutions to take place.

On top of that, there are some questions of civil law which prevent the few civil actions to succeed. This is first due to the cost of the legal action: many shareholders suffer insignificant losses and therefore it would be unwise to sue unless the action is brought through an association of investors, but the procedure for this is too complicated to have investors come forward to join the association and sue. In effect, the only landmark case where this possibility has been used is the Vivendi case (following the departure of CEO Jean-Marie Messier).

The other problem is the proof of the elements that lead to liability (fault, prejudice and causation): evidence seems to be an issue here. In all cases, the claimants prove that the loss they have suffered is different from the own company's loss. This is possible in the case of the *communication d'information fausses ou trompeuses* only if the claimant has sold shares following the misstatement, because the victim/claimant is no longer a shareholder of the company. But if he is still a shareholder, both criminal and civil courts usually consider that the loss incurred is the company's loss and not the shareholder's (although this is slowly changing with a decision by the *Cour de cassation* dated 28 June 2005 where the court starts to recognise that a shareholder may in all cases suffer a loss distinct from the company's loss).

For the defendant to be prosecuted and found guilty, the only evidence is required is that the offence was committed. On the contrary, for the civil action to succeed, the causality link must be proved: therefore the claimant/victim/shareholder will have to prove that he knew about the disclosure of information, such disclosure of information being the reason he has incurred a loss.

One very important difference as well is that there is no rule of disclosure: article 1315 of the French Civil Code states that every claimant must prove that the defendant has a tort or contractual obligation towards him and therefore there can be no order from the judge to have the defendant submit evidence against his will. This means that the claimant will have to provide the evidence for the fault, the prejudice and the causation all by himself. Whereas the prejudice and the causation can be proven by the claimant, this is very difficult for the wrongful act: this one of the reasons that victims use criminal prosecution because the onus will be on the prosecution service to prove that the action was wrong.

9. What is the balance of enforcement as between private litigation and public enforcement via, for example, a securities market regulator or public prosecuting authorities?

a. Securities market regulator

The securities market regulator in France is the *Autorité des marchés financiers* (AMF) since the Financial Security Act of 2003. It has the power to prosecute companies and their managers (or any person related to the financial markets, including investors, journalists, financial analysts, banks and bank employees...) for market misstatements (and for any act contrary to the Authority's Regulations, or more generally anything that goes against the interests of the private investors) and ask for monetary sanctions to be paid to the French Treasury and not to the victims. The maximum amount of these sanctions will be 1.5 million euros or ten times the profits made from the wrongful act (whichever the greatest).

The goal of the public authorities involved in the regulation of the stock market has never been to help investors claim damages following the commitment of a criminal offence. The *Autorité des marchés financiers*, and before it the *Commission des opérations de bourse*, has for purpose to protect savings invested on the stock market in equity or bonds.

The *Commission des opérations de bourse* has a long jurisprudence of inflicting monetary sanctions to companies, those sanctions having been in 60% of all cases due to a misstatement or failure of information to the market. Despite this fact, the COB's operations did not allow it to redistribute the sanctions to the victims of the mentioned offences. This has not changed with the creation of the *Autorité des marchés financiers* in 2003 : at most what victims can do is support their pleadings in criminal or civil court with the decision made by the AMF.

The problem with the AMF sanctions is that the victims of market misstatements have no power to actually trigger the AMF's prosecution. In effect, the only thing that investors could do when discovering that they have been the victim of some fraud by the directors of the company they have invested in is to blow the whistle so that the AMF can launch its own investigation which will lead to the aforementioned monetary sanctions. But even this whistle blowing does not allow them to recuperate any of these sanctions which would act as damages. This confirms that the AMF's purpose is to protect savings and the market in general, not individual investors.

An appeal against the AMF's decision can be made before the Paris Court of Appeal if the decision concerns non-professionals (e.g. directors, issuers, investors, laymen) and before the *Conseil d'Etat* if the decision concerns professionals (e.g. banks).

As soon as the AMF is made aware of facts that are likely to be a criminal offence, including the *communication ou diffusion d'informations fausses ou trompeuses*, it must notify the Prosecution Service immediately which will decide to take action or not. The same happens in reverse: the Prosecution Service must inform the AMF of facts that could be prosecuted under its General Regulation that it would be made aware of.

b. Criminal prosecution

Alongside the AMF procedure, criminal courts (mostly the *tribunal correctionnel* since market offences are more likely to be *délits* than *crimes*) can prosecute companies (corporate entities can be prosecuted for any criminal offence since January 1st 2006) or their directors for market misstatements which constitute criminal offences.

The prosecution can be launched either by the *Procureur de la République* (the equivalent of the Crown Prosecution Service) or by a victim through a *plainte avec constitution de partie civile* (a crime report in which the victim also sues the defendant for damages in tort). This criminal procedure is much more effective for the victims of market misstatements since it allows them to be awarded damages. The prosecution is launched by the victim in 77 % of cases (this figure applies to financial criminal offences in general, and not only to the ones pertaining to this review). This form of action is has increased in recent years and is a way to circumvent the potential inertia of the Prosecution in political cases.

How can the victim force the prosecution to start its investigations? By pressing charges either against no designated defendant or against someone considered to be the offender. This *plainte* is

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made before the *juge d'instruction*, the judge in charge of investigations in the prosecution of some criminal offences. For this to be accepted by the judge, the facts of the case must fall within the scope of a criminal offence, and the victim must show that he/she could have suffered a loss due to the criminal offence.

This enables the shareholder/victim to launch criminal investigations, but the victim is in no way forced to ask for damages.

For this *constitution de partie civile* to be effective, and therefore for the prosecution to be launched, the judge receiving the *plainte* must acknowledge him and ask the victim to deposit a sum of money in court as guarantee. The amount asked for depends on the financial resources of the victim/plaintiff; if it is not deposited within the time period stated by the judge, the claim is void and the prosecution not launched.

Although statistics on that matter cannot be obtained, I can infer from the cases I had to read that a large majority of the cases concerning this issue are criminal cases (containing a civil action within) whereas the purely civil cases are less frequent.