Feature

KEY POINTS

- Section 90 of FSMA 2000 provides an invaluable mechanism by which investors who have suffered loss as a result of an untrue or misleading prospectus can seek redress.
- One key question to consider will be whether the prospectus provided investors with the "necessary information" required under FSMA 2000.
- It is unlikely that an issuer will be able to rely on defences to liability under Sch 10 FSMA 2000 simply because the prospectus has been approved by a third party, such as the FCA or a sponsor.
- Whilst Group Litigation Orders can be effective tools for managing prospectus claims, think carefully beforehand about funding, settlement, and the split of retail vs institutional investors.

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Prospectus Litigation: lessons learned from *The RBS Rights Issue Litigation*

This article – written by members of the counsel team for the Signature Law claimants in *The RBS Rights Issue Litigation* – summarises the key issues and arguments likely to be relevant for anybody considering litigation in this area. The authors also provide an insight into some of the lessons that can be learned from the complex and long-running RBS Rights Issue Litigation.

PROSPECTUS CLAIMS: THE ESSENTIALS

For claimants who have suffered a loss after acquiring securities offered by a prospectus, s 90 of the Financial Services and Markets Act 2000 (FSMA) provides an invaluable mechanism for seeking redress. Under s 90 an issuer will be liable to any investor who has suffered loss as a result of:

- an untrue or misleading statement in the prospectus; or
- the omission of any "necessary information".

Importantly, under s 90 the investor need not show reliance on any particular statement (or omission), nor even that they read the prospectus: once the conditions of s 90 are satisfied then, subject to defences, liability is made out.

The concept of "necessary information" is integral to the legal regime governing prospectuses. It is defined in s 87(2) FSMA as:

> "information necessary to enable investors to make an informed assessment of (a) the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the transferable securities and of any guarantor; and (b) the rights attaching to the transferable securities."

That information has to be accessible: s 87A provides that the necessary information must be presented in a form which is comprehensible and easy to analyse, having regard to the particular nature of the transferable securities and their issuer. In practice, what does that mean?

No case on s 90 FSMA is yet to reach trial, and when it does, the precise scope of the "necessary information" required by s 87 is likely to be a hotly contested issue. But it must follow from the wording of the provision that a prospectus is required to contain information both as to the current financial position of the issuer, and its future prospects. That information must be true, complete and not misleading.

A key issue is whether it can be assumed – in the issuer`s favour – that the reader of the prospectus has particular characteristics or knowledge. Is the reader of the prospectus expected to be abreast of the financial news, for example? Can an issuer escape liability if its prospectus omitted necessary information, but that information was nonetheless known to the market and could have been accessed through other sources?

One problem with this line of argument is that prospectuses are also subject to regulation at the European level: s 90 must be read in light of the Prospectus Directive 2003/71, the Prospectus Regulation 89/2004, and the recommendations of the Commission of European Securities Regulators (CESR). One of the avowed purposes of the Prospectus Directive is to ensure that a prospectus can be relied upon by investors across the EU members states. In that context, the concept of "market knowledge" becomes nebulous: if a prospectus must mean the same thing to an investor in Sweden as it does to an investor in Spain, then arguably the investor cannot reasonably be deemed to have relevant knowledge that is not contained within the prospectus itself.

The whole question of how "market knowledge" can even be evidenced and established was hotly contested in the *RBS* case. Thus, an issuer may well wish to seek to use investment analysts or even survey evidence to try to show what "the market" knew at a particular point in time. In order to achieve a uniform minimum level of investor information it is likely that a prospectus must be a self-contained document: if it were otherwise then a great deal of time and cost would be spent seeking to establish that "the market" knew the matters which were omitted from the prospectus, and knew facts which would ensure a reader of the prospectus was not misled.

As to the qualities of the investor who is to be given the necessary information, an approach which provides protection to the most unsophisticated investor accords with the purpose of the Prospectus Directive and is probably the most practicable. However, this is a fact sensitive inquiry and there may be circumstances in which an issuer could demonstrate that any investor in that particular share issue would have a specific level of minimum knowledge which would be the proper starting point for the provision of necessary information.

THE ISSUER STRIKES BACK: DEFENCES TO LIABILITY

If a claimant can satisfy these initial hurdles and establish a *prima facie* breach of s 90, then the attention shifts to whether the issuer can nonetheless defend itself from liability. Schedule 10 para 1(2) of FSMA provides the issuer with a defence:

> "(2) A person does not incur any liability under section 90(1) for loss caused by a statement if he satisfies the court that, at the time when the [prospectus] [was] submitted to the competent authority, he reasonably believed (having made such enquiries, if any, as were reasonable) that –
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> (a) the statement was true and not misleading, or
> (b) the matter whose omission caused the loss was properly omitted,
>
> and that one or more of the conditions set out in sub-paragraph (3) is satisfied."

The burden is on the defendant to satisfy these requirements. The Sch 10 defences contain both subjective and objective elements: the issuer must actually believe that the prospectus was complete, accurate and not misleading, and that belief must be reasonable. In addition, it seems clear on its face that Sch 10 para 1 requires the defendant to have made *all* such enquiries, if any, as were reasonable. Pursuing a few, obvious lines of enquiry is unlikely to be sufficient.

External approval of the prospectus

The Sch 10 defences give rise to two interesting and difficult issues. The first is: how much (if at all) can the issuer rely on the fact that the prospectus was approved by third parties?

Before a prospectus can be issued it is required by statute to be approved by the FCA as the "competent authority": s 87A FSMA. And where the issuer seeks a premium listing on, eg the London Stock Exchange, it is required by the Listing Rules to appoint a sponsor. That sponsor must itself be reasonably satisfied, after making due and careful enquiry, that the issuer has complied with the requirements of s 90 FSMA.

The short answer is that the approval of the FCA or a sponsor might in some cases be a potent point in the issuer's favour, but external approval will rarely, if ever, be sufficient to make out the Sch 10 defence. First, that is because approval by an external body cannot obviate the statutory requirement for the issuer to have itself carried out all reasonable enquiries in relation to the prospectus. Second, whether the FCA (or a sponsor) has approved the prospectus will very much depend on what information it has been provided with. In normal circumstances the issuer will always have access to more information than it provides either to the FCA or to its sponsor. And third, and relatedly, it will be a rare case where the FCA or a sponsor is able to spot an omission.

Attribution of belief to the issuer

The second difficult issue is: whose belief is deemed to be that of the issuer for the purposes of Sch 10? That question becomes pivotal in a situation where some employees or members of the issuer can make out the Sch 10 defence, but some cannot; and where a breach of s 90 has already been proven, that will almost always be the case.

For an issuer, the Sch 10 defences create a real tension. To avoid liability in the first place, it will want to do all it can to ensure the prospectus is accurate, complete and not misleading. Normally that will involve bringing in as much knowledge as possible from across the business. But when it comes to the Sch 10 defence, the issuer will typically prefer that the court focuses on the directors or senior managers who took ultimate responsibility for signing off on the prospectus, rather than the more junior employees who took an active role in drafting it.

Following Lord Hoffman in *Meridian Global Funds Management Asia Ltd v Securities Commission*,[1] the issue will be determined by looking to the purpose of the statute. But since no case dealing with Sch 10 has yet reached trial, the question of how to apply that test remains at large. There is a balance to be struck so that the attribution rules are practical and workable, but also ensure that an issuer cannot insulate its knowledge to board members with only high level knowledge. It may be that the Court will find the purpose of s 90 is achieved by taking the minds of the board or any committee responsible for the approval of the prospectus. This has the appeal of simplicity and it might well be said that the reasonableness requirement prevents an issuer from placing its board/committee in an information silo.

However, what will likely be required is a close investigation on the facts as to how the issuer in question made decisions regarding the contents of the prospectus. There may be circumstances where the facts show that a board by its conduct delegated the production of parts of a prospectus to individuals outside of the board/committee, and in those cases their state of mind will be material.

MANAGING PROSPECTUS CLAIMS

By their very nature, prospectus claims are likely to involve a large number of claimants. Depending on the nature of the issuer, its shares may have been acquired by institutions, individuals, or a mixture of both. One important issue when dealing with prospectus claims is then how to run a claim of this size and complexity. The answer may be: a Group Litigation Order, or GLO.

What are GLOs?

GLOs offer a special procedure for the management of claims which raise a common issue of fact or law. In order to qualify for a GLO the court requires:

- the existence of at least two claimants;
- who seriously intend to proceed;
- and that the claims raise common or related issues of fact or law: see CPR 19.11 and *Alyson Austin v Miller Argent*.[2]

A GLO will only be ordered when there are "no other satisfactory means of resolving the dispute": *Hobson v Ashton Morton*.[3]

Once the GLO is made, any subsequent judgment will bind all the claimants on the GLO register: CPR 19.13(1)(a).

Biog box

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The court is also likely to set a cut-off date after which no further claimants can join the GLO without the court's permission: CPR 19.13(3). That is an important factor when considering the right time to apply for a GLO.

The perks – and challenges – of GLOs

There are three key advantages to using a GLO to manage prospectus claims.

- First, GLOs provide a mechanism which allows individual claimants – each with a low value claim – access to justice.
- Second, the size of the collective claim makes it more likely that costs protection mechanisms (notably ATE insurance) and funding can be put in place.
- Third, the costs risk is spread amongst the claimants: CPR 46.6(3) mandates that unless the court orders otherwise, each group litigant will be severally liable for costs.

But GLOs are not without their difficulties. The need to secure funding, to establish the legal team, and to "build a book" of claimants means that work will be heavily front-loaded. GLOs are almost certainly slower than standard litigation, and costs are likely to be high (although the court has power to impose costs budgeting and costs management orders, and has shown a willingness to do so in a GLO context: see *Sharp v Blank*[4]).

Particular challenges may arise where the claimants are a mix of both institutional and individual claimants. Where that arises the GLO solicitors have the difficult task of managing the needs and expectations of two very different sorts of clients: institutions with independent advice and an eye on their bottom line, and individual investors who often want their day in court.

Structuring a GLO

The ordinary course is for one firm of solicitors to become the lead solicitor for all GLO claimants: see CPR 19.13(c). But that is not always the case: in *The RBS Rights Issue Litigation* the claimants were represented by three separate lead groups, each retaining their own team of solicitors and counsel. The feature of three lead groups was a reflection of the enormous size of the case against RBS and also the spread of claimants between groups and consequential spread of funding.

There are inherent tensions in any GLO when it contains both institutional investors and retail investors. The former are likely to be independently advised, driven by pure commercial considerations and have no emotional investment in the litigation. The latter are likely to rely entirely upon their litigation legal team, potentially have a profound economic interest in the level of damages and have a deep personal investment in seeing the case through to a trial where the issuer and directors are held to account. The inevitable result is that these two sets of litigation have different risk appetites and different levels of commitment to willing to press on all the way to trial.

A clear lesson learned from *RBS* is the grave danger of having multiple lead groups. As is now well-known, in *RBS* all the lead claimant groups bar one settled in late 2016. This left the remaining Signature Law group in very challenging circumstances where the funding to trial, scope of the trial and legal resources changed almost overnight. If more than one lead group is to be permitted in a GLO, it now seems very likely that at the permission stage of the GLO such lead groups will have to engage in explaining how the GLO can operate properly if one or more lead groups settle.

Even if there is only one lead group it is critical for the effective management of the GLO that it is structured from the beginning to have the funding and ATE insurance (which is likely to be necessary if any retail investor is involved) in place to carry the proceedings to the end of trial even if, for instance, all the institutional investors accepted a settlement offer which no retail investor was willing to take.

Are GLOs the future of s 90 claims?

Whether or not GLOs become used more commonly going forward will depend on the makeup of the claimant group. If the claimants include retail investors then it is very likely that the benefits of the GLO will outweigh its disadvantages. If the claimants are exclusively institutional then a GLO is less likely be ordered, unless there are a multiplicity of proceedings.

In all events the courts are now likely to adopt a very careful scrutiny of how a GLO will be able to pay its legal expenses and its costs to trial, given the risks of settlement. It is likely that s 90 GLOs in the future will not be of the magnitude of *RBS* and are much more likely to have only one lead group, or possibly have a split between a lead group of institutional investors and a lead group of retail investors. ■

1 [1995] 2 AC 500.
2 [2011] EWCA Civ 928.
3 [2006] EWHC 1134 (QB).
4 [2017] EWHC 141 (Ch).

Further Reading:

- Collective action and securities law in the UK: recent and anticipated developments and international trends (2017) 5 JIBFL 299.
- Extension of the statutory regime for issuer liability (2010) 11 JIBFL 682.
- LexisPSL: Financial Services: Prospectus requirements – general information.