Investor Protection and Issuer Confidence after Kolassa

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The decision rendered by the ECJ in *Kolassa* (Case C-375/13) offers a good opportunity to assess the European rules on jurisdiction from the point of view of investor protection and issuer confidence. A first comment on *Kolassa* has already been published on this Blog by Professor Matthias Lehmann. In his post, Professor Lehmann mainly focuses on the application of Art. 5(3) Brussels I Regulation to prospectus liability and on the evidence a court needs to consider when the disputed facts are relevant both for establishing jurisdiction and for deciding on the merit (these topics are addressed respectively in the third and the fourth questions referred to the ECJ). Full reference can therefore be made to Professor Lehmann's accurate analysis both for such points and for the description of the relevant facts. This post will instead sketch some general remarks from the perspective of financial markets law (for a more detailed analysis based on the Opinion of the Advocate General in *Kolassa* see Gargantini, Jurisdictional Issues in the Circulation and Holding of (Intermediated) Securities: The Advocate General's Opinion in Kolassa V. Barclays, Rivista di diritto internazionale privato e processuale (2014), 1095).

To better understand the issues raised by *Kolassa*, it is worth considering in more detail the first two questions referred by the Austrian court, namely whether for the purpose of Art. 15 Brussels I Regulation Barclays, the issuing company, and Mr Kolassa, the final investor, are part of a contract, or whether for the purpose of Art. 5(1) Brussels I Regulation the relationship between them can at least be considered contractual. As opposed to the claim considered by the third question – which only refers to prospectus liability and to "breach of obligations to protect and advise" – the claims dealt with by the first two questions were also based on "the bonds terms and conditions". Hence, it appears that Mr Kolassa was relying not only on prospectus liability, but also on a direct violation of the bond terms, that being the missing payments. Therefore, the clarifications provided by the ECJ on prospectus liability are not the full story. First, nothing prevents investors from filing claims exclusively – or, as Mr Kolassa did, also – on the basis of violation of the bond terms and conditions. Second, it might well be the case that a security

offering is carried out with no prospectus being published at all, for example because one of the exemptions set forth by Art. 4 Directive 2003/71/EC (on the prospectus to be published when securities are offered to the public or admitted to trading) applies.

The first two questions referred to the ECJ raise difficult problems because, in *Kolassa*, not only are the securities bought on the secondary market, with no direct contact between issuer and investor, but they are also held by Mr Kolassa's bank (*direktanlage*) rather than by Mr Kolassa himself. In such a scheme, Mr Kolassa only has a claim against his bank and cannot be regarded as the holder of the securities. The distinction between the problems raised by security circulation, on the one hand, and security holding, on the other, is clearly drawn in the questions referred by the Austrian courts. Both the Opinion of the Advocate General and the ECJ decision deny that Art. 5(1) and Art. 15 apply, but they are unfortunately not as clear as the referring court in discerning the two aspects. Para. 26 of the decision seemingly links the absence of a contract to the fact that Mr Kolassa is not the bearer of the bond. Hence, it could be inferred that the "chain of contracts through which certain rights and obligations of the professional […] are transferred to the consumer" (para. 30) refers to the contracts that compose the holding chain of the securities. However, para. 35 is more elliptical and might also include security circulation when it refers to "an applicant who, as a consumer, has acquired a bearer bond from a third party professional, without a contract having been concluded between that consumer and the issuer of the bond". Likewise, the applicability of Art. 5(1) is excluded on the basis that "a legal obligation freely consented to by Barclays Bank with respect to Mr Kolassa is lacking", it being unclear whether this is linked to the fact that the bonds were purchased on the secondary market or to the fact that *direktanlage*, rather than Mr Kolassa, should be regarded as the bearer of the certificate (para. 40).

Whether the inapplicability of Arts. 5(1) and 15 Brussels I derives from the fact that the bonds are bought from previous purchasers rather than underwritten directly from the issuer or, instead, from the fact that Mr Kolassa is not the holder of the securities is however key to understanding the implications of the decision. If the first explanation prevailed, the consumer protection regime of Art. 15 would not easily apply in securities offerings whenever – as is often the case – a bank syndicate first underwrote the securities and then resold them to investors at

large (so-called “firm commitment syndicate”). At the same time, ruling out a contractual obligation pursuant to Art. 5(1) on similar grounds would imply that issuers might be held liable for violation of the bonds’ terms and conditions in any jurisdiction where their investors suffered economic loss according to Art. 5(3). Such a system would exclude retail investor protection with no economic rationale and would paradoxically expose the offering companies to the risk of being sued by professional investors in jurisdictions where they published no prospectus and, consequently, addressed no investor.

Therefore, although the distinction between circulation and holding of securities may not be decisive in *Kolassa*, its implications remain whenever the investor/accountholder is the bearer of the relevant securities. Since *Kolassa* does not provide a conclusive answer to these questions, it might be appropriate to give a narrow reading to the decision, hence considering the intermediated and indirect holding of the securities through *direktanlage* as the reason why Arts. 5(1) and 15 do not apply.

To be sure, even a restrictive reading of *Kolassa*, although preferable, is no panacea. First, it would leave open the question whether the circulation of the securities might still prevent the identification of a contract or even a contractual obligation between issuers and investors pursuant to Arts. 15 and 5 respectively. This would seem to be the case for Art. 15, because ECJ case law usually requires a direct contact between the two parties (see Von Hein, Verstärkung des Kapitalanlegerschutzes: Das Europäische Zivilprozessrecht auf dem Prüfstand, in Eur. Zeitschrift für Wirtschaftsrecht, 2011, 370). A different result may perhaps be reached for Art. 5(1), considering that it might apply in the absence of a direct contact and that the ECJ has stated that conditions incorporated in a security may be transferred along with the security when this is handed over (see e.g. *Coreck*, Case C-387/98), which is exactly the purpose of incorporating a restitution obligation into a bond. Second, linking the applicability of Arts. 5(1) and 15 to the formal qualification of the investor as security holder might easily create a differential treatment of investors that are regarded as mere beneficial owners in countries such as the United Kingdom, where security holding is mainly based on trusts. In this context, the strict interpretation of Art. 15 and the *raison d’être* of the autonomous interpretation of jurisdictional rules come into conflict.

To what extent a different reading of the applicable rules could ensure a better regulatory framework remains to be seen. The Brussels I Regulation does not

always seem to leave room for different interpretations, at least in the light of consolidated case law. Art. 15 and its traditional understanding is a clear example. What is sure, from the point of view of securities law, is that the drawbacks of the current system reduce both issuer confidence and investor protection.