

CAPITAL MARKETS AND PROTECTION OF PRIVATE INVESTORS IN CROSS-BORDER TRANSACTIONS

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INTRODUCTION: GLOBAL MARKETS AND THE NEED TO PROTECT PRIVATE INVESTORS (I)

- CROSS-BORDER RETAIL INVESTMENT HAS BECOME A MASS PHENOMENON
- IN THESE SITUATIONS THE PRIVATE INVESTOR HAS HIS RESIDENCE IN ONE COUNTRY AND THE FINANCIAL SERVICE PROVIDER IN ANOTHER
- THE MAIN FACTORS WHICH CONTRIBUTE TO THE INCREASE OF CROSS-BORDER RETAIL INVESTMENT ARE:
 - *Technological changes foster electronic commerce an the Internet becomes essential for the dissemination of information*
 - *The intangible nature of financial services makes them especially suited for distance selling*
 - *Insufficient liquidity of certain national markets prompt intermediaries to channel their customers to foreign markets*

INTRODUCTION: GLOBAL MARKETS AND THE NEED TO PROTECT PRIVATE INVESTORS (II)

- CONSUMER CONFIDENCE IN CROSS-BORDER TRANSACTIONS IS ESSENTIAL TO ENSURE THE FREE MOVEMENT OF FINANCIAL SERVICES WITHIN THE EU

- SPECIFIC RISKS FOR PRIVATE INVESTORS TRADING SECURITIES WITH FINANCIAL SERVICE PROVIDERS ESTABLISHED ABROAD:

- *Lack of reliable information about the provider and the contract*
- *Uncertainties about the formation and content of distance contracts*
- *High costs associated to litigation in foreign countries*
- *Uncertainty about where to sue the provider*
- *Uncertainty about the rules applicable, especially because the rules for the protection of private investors in international contracts are not uniform*

CROSS-BORDER TRANSACTIONS WITH PRIVATE INVESTORS: OVERVIEW OF EU LAW (I)

SUBSTANTIVE RULES PROTECTING PRIVATE INVESTORS TRADING IN SECURITIES

- Protection of investors is one of the basic goals of all the regulatory regime governing capital markets:
- Rules on market organization and supervision, admission of products, operation requirements for financial service providers, disclosure rules to ensure transparency, insider trading or takeover bids are aimed, among other goals, to protect investors
- This presentation however focuses on the position of private investors in international contracts: how to solve the uncertainties on the rights and duties of private investors when contracting with foreign traders

CROSS-BORDER TRANSACTIONS WITH PRIVATE INVESTORS: OVERVIEW OF EU LAW (II)

Substantive rules concerning the rights and duties of private investors in distance contracts have been harmonized at EU level mainly in these Directives:

- *Directive 2002/65/EC, of 23 September 2002, concerning the distance marketing of consumer financial services*
- *Directive 2000/31/EC, of 8 June 2000 on electronic commerce*

CROSS- BORDER TRANSACTIONS WITH PRIVATE INVESTORS: OVERVIEW OF EU LAW (III)

Other Directives on different aspects of capital markets law can be decisive in certain claims of private investors against traders, investment firms or listed companies, as is the case with some rules established in these Directives:

- Directive 2001/34/CE, of 28 May 2001, on the admission of securities to official stock exchange listing and on information to be published on those securities
- Directive 2004/25/EC of 21 April 2004 on takeover bids
- Directive 2004/39/EC, of 21 April 2004, on markets in financial instruments

CROSS-BORDER TRANSACTIONS WITH PRIVATE INVESTORS: OVERVIEW OF EU LAW (V)

SCOPE OF UNIFICATION OF PRIVATE INTERNATIONAL LAW RULES

TERRITORIAL JURISDICTION

- *Regulation 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters* covers both contractual and non-contractual claims
- The territorial scope of application of the rules on jurisdiction does not cover litigation usually when the defendant's domicile is outside the EU
 - Regulation applies if the defendant is domiciled in a Member State (or in some cases in which he has a branch or agency in a Member State)
 - For example, when US firms are sued in the EU, Member State national rules on jurisdiction apply (which usually establish additional grounds of jurisdiction)
 - As regards consumer transactions the Regulation (arts. 15 to 17) establishes strict rules on jurisdiction

CROSS-BORDER TRANSACTIONS WITH PRIVATE INVESTORS: OVERVIEW OF EU LAW (VI)

ENFORCEMENT

- Regulation 44/2001 guarantees free movement of judgments within the EU (although some restrictions apply)
- Regulation applies when a judgment given in a Member State is to be recognised or enforced in any other Member State
- Regulation 44/2001 is fully applicable to the recognition of judgments in cases in which the defendant's domicile was in a non Member State (for example in the US)
- The Regulation covers the enforcement of both contractual and non-contractual claims
- The Regulation does not cover the enforcement of administrative sanctions, as those typically imposed by the bodies supervising stock exchanges

CROSS-BORDER TRANSACTIONS WITH PRIVATE INVESTORS: OVERVIEW OF EU LAW (VII)

APPLICABLE LAW: CONTRACTS

Rome Convention on the law applicable to contractual obligations of 1980

- Unifies within the EU the rules to determine the law applicable to all international contracts (its rules apply regardless of the location of the claimant and the defendant)
- Establishes a special regime for consumers contracts
- The Convention does not apply to obligations arising out of the negotiable character of negotiable instruments
- The Convention does not apply to questions governed by the law of companies
- Currently under revision

CROSS-BORDER TRANSACTIONS WITH PRIVATE INVESTORS: OVERVIEW OF EU LAW (VIII)

APPLICABLE LAW: NON CONTRACTUAL CLAIMS

- Rules on this issue are not yet unified within the EU
- The situation is to change dramatically in the near future with the approval of the long-time awaited Regulation on the law applicable to non-contractual obligations
- The future Regulation Unifies will apply regardless of the location of the claimant and the defendant, as the Rome Convention

DISPUTE SETTLEMENT AND TERRITORIAL JURISDICTION (I)

Regulation 44/2001 establishes a high level of protection of consumers in certain international contracts

Forum selection clauses are a basic mechanism to guarantee legal certainty in international transactions. However, Regulation 44/2001 limits the enforceability of choice of forum clauses in consumer contracts: the rationale behind the EU rules (art. 15 to 17 Regulation 44/2001)

Forum agreements will normally not be enforceable in consumer contracts that meet the requirements of article 15.1.c) Regulation 44/2001.

Moreover, in those situations, according to articles 15-17 of the Regulation:

- A consumer may bring proceedings against the other party to a contract in the courts of the Member State where the consumer is domiciled (optional)
- Proceedings may be brought against a consumer only in the courts of the Member State in which the consumer is domiciled (mandatory)

DISPUTE SETTLEMENT AND TERRITORIAL JURISDICTION (II)

ARE PRIVATE INVESTORS PROTECTED AS CONSUMERS IN THE FRAMEWORK OF REGULATION 44/2001?

Regulation 44/2001 does not include a clear definition of consumer

In principle private investors can be considered consumers for the purposes of article 15.1.c) Regulation 44/2001. According to paragraph 8 of the Preamble of Directive 2002/65/CE concerning the distance marketing of financial services, this Directive does not affect the applicability to those contracts of Regulation 44/2001 and the 1980 Rome Convention on the law applicable to contractual obligations.

However, two issues remain controversial for private investors to benefit from the protection granted to consumers in articles 15-17 Regulation 44/2001: the purpose of the contract and the nature of the private investor as a passive consumer in international transactions

DISPUTE SETTLEMENT AND TERRITORIAL JURISDICTION (III)

According to article 15.1 Regulation 44/2001, a consumer contract is a contract concluded by a person “for a purpose which can be regarded as being outside his trade or profession”

Case-law of the European Court of Justice

- Judgment of 19 January 1993, *Shearson Lehman Hutton*, case C-89/91
- Judgment of 15 September 1994, *Brenner*, case C-318/93

The special need of protection which justifies the protective regime of articles 15-17 Regulation 44/2001 can be present in contracts on securities celebrated between a private investor and a provider of financial services

DISPUTE SETTLEMENT AND TERRITORIAL JURISDICTION (IV)

According to article 15.1.c) Regulation 44/2001, to benefit from the protective regime on jurisdiction the consumer contract must meet another requirement:

“the contract has been concluded with a person who pursues commercial or professional activities in the Member State of the consumer's domicile or, by any means, directs such activities to that Member State or to several States including that Member State, and the contract falls within the scope of such activities”. (art. 15.1.c Regulation 44/2001)”

This rule applies the traditional distinction between active consumers and passive consumers to the new technological environment, where the rule is especially important

DISPUTE SETTLEMENT AND TERRITORIAL JURISDICTION (V)

COMPETENT COURTS WHEN THE INVESTOR DOES NOT BENEFIT FROM THE PROTECTIVE RULES OF ARTICLES 15-17 REGULATION 44/2001

- choice of forum clauses (art. 23-24 Reg. 44/2001)
- defendant's domicile (art. 2 Reg. 44/2001)
- place of performance (art. 5.1 Reg. 44/2001)
 - sale of goods: place of delivery (applicability?)
 - provision of services: place where they are provided (criteria to determine that place)

DISPUTE SETTLEMENT AND TERRITORIAL JURISDICTION (VI)

COMPETENT COURTS IN CASE OF NON-CONTRACTUAL CLAIMS

- defendant's domicile (art. 2 Reg. 44/2001)
- courts for the place where the harmful event occurred or may occur (art. 5.3 Reg. 44/2001)
- criteria to determine the place of the harmful event

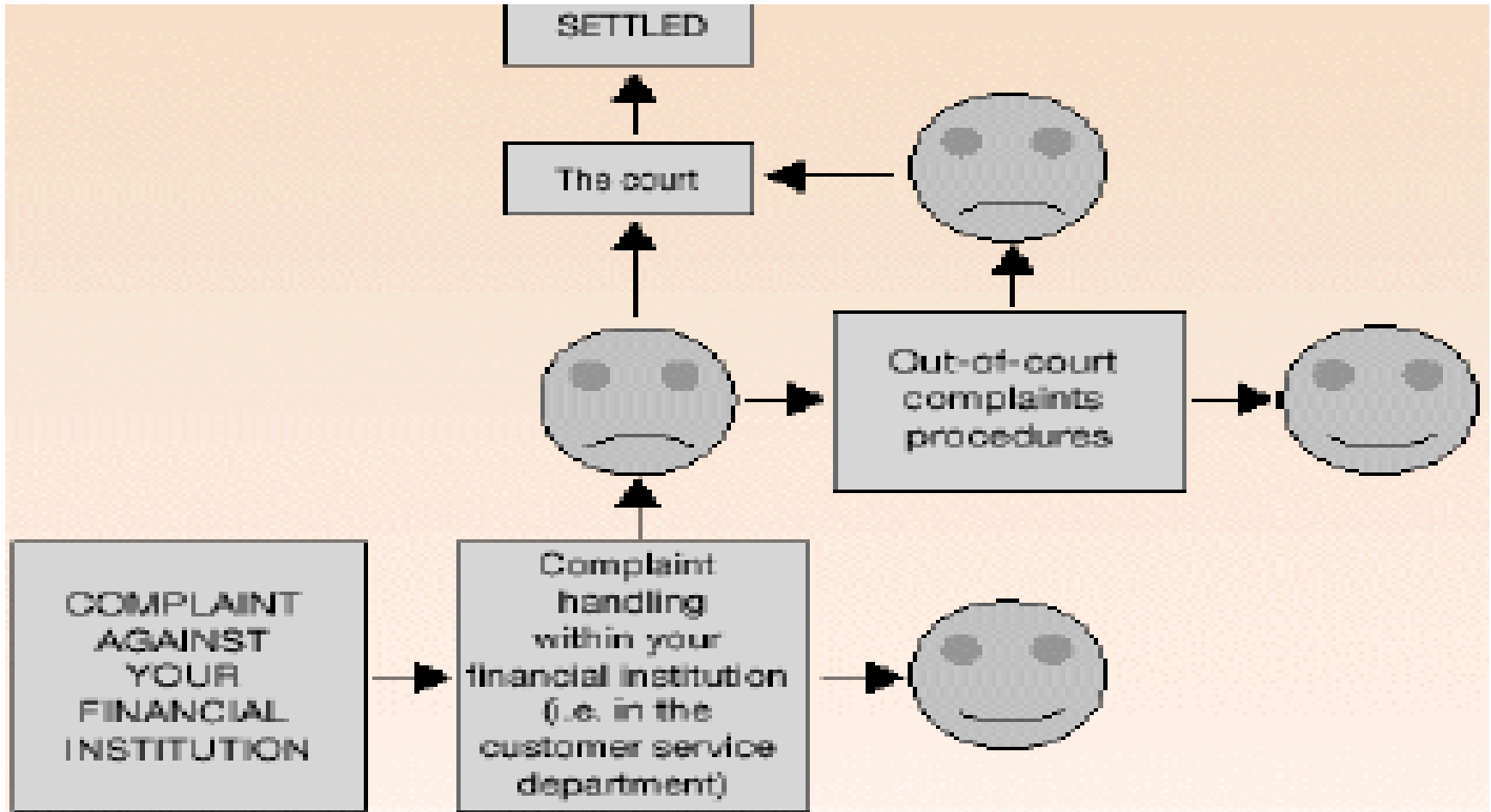
DISPUTE SETTLEMENT AND TERRITORIAL JURISDICTION (VII)

OUT OF COURT PROCEDURES

- Out of court procedures are a cheaper and quicker alternative to court procedures.
- They are voluntary and typically of national scope.
- This alternative can be specially useful in the context of international complaints due to the complexity and costs of litigating abroad.
- FIN-NET has been developed as a specific network to handle cross-border complaints in Europe
- The complaints will normally be handled by a complaint body of the country where the financial service provider is located

FIN-NET

The cross-border out-of-court complaints network for financial services



APPLICABLE LAW ISSUES (I)

- The law applicable to contracts trading on securities is determined by the rules of the Rome Convention
- According to Article 1.2.c), the Convention is not applicable only to the questions which arise out of the negotiable character of negotiable instruments
- On the contrary, the 1980 Vienna Convention on the international sale of goods does not apply to the sale of securities and financial instruments -art. 2.d) Vienna Convention-

APPLICABLE LAW ISSUES (II)

The most controversial questions which raise the application of the Rome Convention to international contracts on securities are, among others:

- can private investors be protected as consumers in the framework of article 5?
- what is the applicable law when article 5 does not apply?
- what is the scope of the *lex contractus* and if other countries' laws can also affect these transactions?

APPLICABLE LAW ISSUES (III)

- Consumer contracts are subject to special treatment under the Rome Convention: art. 5.2 applies to private investors contracts with providers of financial services business in terms very similar of those of art. 15.1.c) Regulation 44/2001

- The special rules for B2C contracts entered into the circumstances established in article 5.2 of the Rome Convention are:
 - a) Limited enforceability of choice of law agreements: the consumer can not be deprived of the protection provided to him by the laws of the Member State in which he has his residence
 - b) In the absence of a choice of law a B2C contract is governed by the law of the country in which the consumer has his residence

APPLICABLE LAW ISSUES (IV)

However, when the consumer protection regime does not apply, the applicable law to the contract will usually be that of the domicile of the provider of financial services:

- because the contract may include a choice of law clause (art. 3)
- because under article 4 the party performing the characteristic performance will usually be the provider of financial services

APPLICABLE LAW ISSUES (V)

The scope of application of the *lex contractus* includes:

- Formation, validity and interpretation of the contract
- Performance of the contract
- Rights and obligations of the parties
- Consequences of breach (assessment of damages)
- Consequences of nullity of the contract

