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News Bulletin

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Extension of the UK Statutory Liability Regime for Issuers of Securities

Background

The Financial Services and Markets Act 2000 (Liability of Issuers) Regulations (the "Regulations")[1] will be coming into force and will extend the statutory liability of issuers in connection with information published on or after 1 October 2010.

The Regulations were adopted following HM Treasury's public consultations[2] and the independent review and ensuing report to the HM Treasury by Professor Paul Davies QC.[3]

Section 90A of the Financial Services and Markets Act 2000 ("FSMA"), which came into effect on 8 November 2006, established the current statutory liability regime, under which relevant issuers may be liable for fraudulent misstatements or omissions in the financial reports which they publish under the Disclosure and Transparency Rules ("DTR") implementing the Transparency Directive.[4]

The Regulations will substitute a new Section 90A ("New Section 90A") in FSMA and insert a new Schedule 10A ("New Schedule 10A"), which will be applicable to information first published on or after 1 October 2010.

Under transitional provisions, the current Section 90A ("Current Section 90A") provisions (in the form inserted by the Companies Act 2006) will continue to apply to information first published before 1 October 2010.

We summarise below the main provisions of the current regime and the changes which will be introduced by the extended regime from 1 October 2010.

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[1] [Final draft] The Financial Services and Markets Act 2000 (Liability of Issuers) Regulations 2010, http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/consult_issuerliability_regs080310.pdf. *See also* Explanatory Memorandum to The Financial Services and Markets Act 2000 (Liability of Issuers) Regulations 2010, http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/consult_issueliaibility_memorandum.pdf.

[2] HM Treasury's consultation paper: Extension of the statutory regime for issuer liability (17 July 2008), www.hm-treasury.gov.uk/media/2/5/issuerliability_170708.pdf (comments deadline: 9 October 2008); HM Treasury's Extension of the Statutory Regime for Issuer Liability: a Response to Consultation (9 March 2010), http://www.hm-treasury.gov.uk/d/consult_issuerliability_response.pdf. *See also* Morrison & Foerster client alert: Extension of the UK Statutory Regime for Liability of Issuers of Securities (27 August 2008), http://www.mofo.com/files/Publication/08d197f9-d19f-4640-b371-52593bf4c084/Presentation/PublicationAttachment/fa7b3ef7-0502-4168-9ab6-6f403fd22c49/080827UKExtension.pdf.

[3] Davies Review of issuer liability: final report, by Professor Paul Davies QC (4 June 2007), http://www.hm-treasury.gov.uk./media/4/7/davies_review_finalreport_040607.pdf.

[4] Directive (2004/109/EC) on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0038:EN:PDF.

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Scope of the Current Regime under the Current Section 90A

Type of issuers

Currently, the Current Section 90A of FSMA applies to issuers:

- of securities which are traded on a UK regulated market (e.g., main market of the London Stock Exchange, but not AIM);[5] or
- whose home member state is the UK in relation to securities issued by it.

Type of Investors – acquirers only

Current Section 90A protects any person who has acquired securities:

- in reliance on the information in question; and
- at a time when and in circumstances in which it was reasonable for him to rely on it.

The issuer will not be liable to anyone other than the acquirer of securities, such as a person who holds or sells the securities.

Published information

The current regime covers any untrue or misleading statement or omission in the following periodic financial reports published under DTR:

- an annual report;
- a half yearly report;
- an interim management statement; and
- any voluntary preliminary statement published in advance of a report or statement.

Scope of liability

Issuers are liable to pay damages to investors who suffered a loss as a result of:

- any untrue or misleading statement in the relevant published information; or
- omission of any matter required to be included therein.

Requirement of issuer knowledge & investor reliance

An issuer is only liable if:

- a person discharging managerial responsibilities in relation to the publication:
    - knew that the statement was untrue or misleading,
    - was reckless as to whether it was misleading, or
    - knew the omission was a dishonest concealment of a material fact; and

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[5] The Transparency Directive, on which the Current Section 90A is based, defines "securities" by reference to Article 4.1.18 of MiFID (other than money market instruments under Article 4.1.19 of MiFID) and "regulated markets" by reference to Article 4.1.14 of MiFID.

- the investor acquired securities in reliance on the information where it was reasonable for him to rely on that information.

In relation to a publication, "persons discharging managerial responsibilities" are defined as:

- any director of the issuer;
- where an issuer's affairs are managed by its members, any of its members; and
- where an issuer has no persons in the above two categories, any of its senior executives who has responsibilities in relation to the publication.

Mere negligence will not give rise to liability under the Regulations.

Furthermore, there is no requirement that the maker of the statement intended the recipient (investor) to rely on it.

Other liabilities of the issuer not affected

The Current Section 90A explicitly states that the statutory liability regime does not affect the following forms of liability:

- the courts' power to make a restitution order under FSMA, Section 382;
- FSA's power to require restitution under FSMA, Section 384;
- liability to a civil penalty (e.g., a negligence claim under common law); and
- criminal liability.

The Extended Regime under the New Section 90A

Type of issuers

The New Section 90A extends the statutory liability regime to issuers:

- of securities which are traded on any securities market which is located or operating in the UK; or
- whose home member state is the UK in respect of securities issued by it.

This will cover all cases where securities are admitted to trading on a securities market where either the market is situated or operating in the UK or the UK is the issuer's "home state" (either as defined under Article 2.1(i) of the Transparency Directive or otherwise so deemed if the issuer has its registered office (or if none, its head office) in the UK).

For this purpose, the New Schedule 10A states that:

- "securities" means transferable securities within the meaning of Article 4.1.18 of the Markets in Financial Instruments Directive ("MiFID"),[6] other than money-market instruments (as defined in Article 4.1.19 of MiFID); and

[6] Directive 2004/39/EC on Markets in Financial Instruments, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0039:EN:NOT.
[7] *See*, e.g., FSA's List of (UK) multi-lateral trading facilities under MiFID, http://www.fsa.gov.uk/pubs/international/List_MTF.pdf.

- "securities markets" include not only regulated markets but also multilateral trading facilities ("MTFs")[7] and markets or facilities "of a corresponding description" outside the European Economic Area ("EEA").

Therefore, the extended regime will cover:

- issuers of securities that are traded on a UK MTF, including AIM; and
- issuers, whose home state is the UK, of securities that are traded on:
  - an EEA MTF; or
  - an equivalent non-EEA MTF.

Type of investors – continuing holders and sellers, as well as acquirers

In addition to a person who has acquired, a person who (i) continues to hold or (ii) has sold the issuer's securities (in reliance on the relevant published information) will also be entitled to recourse against the issuer under the Regulations.

Acquisition or disposal of securities will include acquiring or disposing of any interest in securities (or contracting therefor).

However, in relation to depositary receipts, derivative instruments or other financial instruments representing securities, the issuer of the underlying securities will only be liable to the investors in the secondary instrument if it has consented to the admission of those secondary instruments to trading.

Such consent will be deemed given where the issuer has accepted responsibility for an offering document prepared for the purposes of the admission of the securities to trading on a securities market.

Scope of liability/Requirement of issuer knowledge – dishonest delays

Whilst fraud (in the civil law sense) will remain the basis for liability, the statutory liability will be extended under the New Section 90A (beyond fraudulent misstatements or omissions) to dishonest delay by the issuer in publishing the relevant information, where the investor suffers a loss as a result of the delay.

However, the issuer will only be liable if the person discharging managerial responsibilities "acted dishonestly" in delaying the publication of the information.

For this purpose, conduct will be regarded as "dishonest" if and only if:

- it is regarded as dishonest by persons who regularly trade on the market in question; and
- the person was aware (or must be taken to have been aware) that it was so regarded.

In its feedback statement to the public consultation in March 2010,[8] the HM Treasury explained that the government will deliberately adopt the criminal (rather than civil) test of dishonesty. In order to be successful, an investor bringing a claim for dishonest delay will have to demonstrate:

- that a particular statement "should have been made at a previous point in time" but was not); and

[8] HM Treasury's Extension of the Statutory Regime for Issuer Liability: a Response to Consultation (9 March 2010), http://www.hm-treasury.gov.uk/d/consult_issuerliability_response.pdf.

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- that the delay resulted from dishonest behaviour which was "intended to enable a gain to be made or to cause loss to another or expose another to the risk of loss."

Published information

The extended regime will apply to all information published by, or the availability of which is announced by, the issuer by a recognised information service ("RIS") or other means required or authorised to be used when an RIS is unavailable.

Therefore, where an announcement refers to a document (e.g., annual accounts) being made available, then the entire document will be subject to the liability regime.

Liability will attach to information which the issuer publishes on an RIS, even if a claimant obtains it from a secondary source (i.e., not directly from the RIS).

Other liabilities of the issuer not affected

The New Section 90A additionally states that the statutory liability regime will not affect the following other forms of civil liability:

- under Section 90 of FSMA (compensation for statements in listing particulars or prospectus);
- under rules made under section 954 of the Companies Act 2006 (compensation);
- for breach of contract;
- under the Misrepresentation Act 1967; and
- arising from a person having assumed responsibility to a particular person for a particular purpose, for the accuracy or completeness of the information.

Next Steps

As discussed above, the extended issuer liability regime will be broader in scope than the current statutory regime and the issuers' potential exposure to liabilities will relate to a wider range of:

- securities markets (UK/EEA MTFs or equivalent non-EEA markets or facilities, *as well as* UK/EEA regulated markets);
- information (all information published, or contained in documents mentioned in any announcements as being available, via recognised means, as well as periodic financial reports);
- investors (continuing holders or sellers, as well as acquirers, of securities); and
- conduct (dishonest delays, as well as false or misleading misstatements or omissions).

Therefore, issuers of securities with a UK connection (e.g., traded on a UK regulated market or MTF or having a UK home state or registered office/head office) should carefully review their internal systems and procedures and implement any necessary changes, in order to minimise the heightened risks of liability which the Regulations will entail.

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