Feature

KEY POINTS

- Consumer investors can only bring prospectus liability claims in their home State if they have concluded a direct contractual relationship with the issuer, and only if the issuer has marketed the securities in their home State.
- Secondary market purchasers cannot invoke Art 5(1), which grants jurisdiction to the courts of the State where the relevant contractual obligation was to be performed.
- Tortious or statutory claims can be brought in the jurisdiction where damage is suffered, which may be where investors' bank accounts are located. Issuers thus face the prospect of litigating parallel claims in multiple jurisdictions.

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Prospectus liability: bracing for parallel claims in multiple jurisdictions

In *Kolassa v Barclays Bank* (C-375/13), the Court of Justice of the European Union (ECJ) was presented with an opportunity to consider a number of related questions on the subject of jurisdiction over claims brought by a consumer investor against a securities issuer. The judgment dismissed some of the more ambitious arguments for granting jurisdiction to the court of the investor's domicile, but leaves some ambiguity as to the application of the various Articles of the Brussels Regulation it considered. The result is that issuers may find it difficult to predict the jurisdictions in which they may face claims from aggrieved investors.

THE FACTS

The case arises from an investment made by Mr Kolassa, a consumer investor domiciled in Austria, into bearer bonds issued by Barclays Bank plc (Barclays), a bank based in the UK (with a branch in Germany).

Mr Kolassa had no direct contractual nexus with Barclays; rather, he had a contractual relationship with his bank in Austria (Direktanlage), which in turn placed an order with its German parent, DAB Bank AG, to acquire the bonds from Barclays. The certificates were held by Direktanlage in its own name in a securities account in Germany. Mr Kolassa had an interest in those certificates but was not entitled to have them transferred into his own name.

Due to fraudulent activity in an underlying portfolio to which the bonds were indexed, the certificates came to be valued at nil, leading Mr Kolassa to bring an action against Barclays in Austria, asserting both contractual claims (including under the bond terms and conditions) and prospectus-related claims. Mr Kolassa argued that the Austrian court had jurisdiction on the basis of the consumer rules in Arts 15 and 16 of Regulation 44/2001 (Brussels Regulation). In the alternative, he also relied on the contract and tort rules in Arts 5(1)(a) and 5(3). The Austrian court referred a series of questions to the ECJ on the proper application of these Articles.[1]

CONSUMER RULE INAPPLICABLE: NO CONTRACT CONCLUDED BETWEEN THE PARTIES

Articles 15 and 16 of the Brussels Regulation allow a claimant to sue in his home State (ie, the Member State in which he is domiciled) if he meets three tests:

- that he is a consumer (acting outside his trade or profession);
- that he has concluded a contract with the defendant; and
- that the defendant pursues commercial or professional activities in the consumer's home State or directs its activities to that State and the contract falls within the scope of such activities (or that the contract falls into certain consumer credit categories).

The ECJ held that Mr Kolassa was a "consumer" for these purposes, and also that the third limb was satisfied because Barclays had published its prospectus in Austria (and could thus be said to have "directed its activity" there).

The live issue was whether a contract had been concluded between Mr Kolassa and Barclays. The Austrian court, in formulating its reference, had identified two issues in this regard. First, did it matter whether the investor held the relevant securities via intermediaries (in this case, Direktanlage)? Second, what would the position be if the investor had acquired the securities from a third party, rather than the issuer?

The ECJ dismissed Mr Kolassa's argument for a broad "economic" notion of a contractual relationship, looking through intermediaries and focusing on beneficial interests. The ECJ held that Art 15 was an exception to the general rules on jurisdiction, and thus ought to be construed narrowly. But the fact that the ECJ held that two of the limbs had been met suggests that a different outcome might have been reached on slightly different facts. If an investor were to execute a subscription agreement in his own name, that would presumably provide the required contractual nexus. However, an investor buying on the secondary market would have no such connection with the issuer.

The ECJ's decision on Art 15 did not directly deal with the Austrian court's question about its applicability to secondary market purchasers. It has been suggested that a secondary market purchaser could not invoke Art 15, because the ECJ would expect there to have been direct contact between the parties in order to do so (Gargantini, "*Investor Protection and Issuer Confidence after Kolassa*", conflictoflaws.net, 10 February 2015). However, if this is applied strictly, it would make Art 15 relatively easy to circumvent, simply by assigning consumer contracts intra-group after they are executed. One would therefore expect that if a contract contains provisions for assignment or transfer, a consumer should still be able to invoke Art 15 as against his counterparty's successor (assignee), even in the absence of any prior direct contact between them. On that basis, a purchaser of transferable securities should be deemed to be as much in a contractual relationship with the issuer as the original subscriber was. (Note, however, the apparently divergent views of the Advocate-General and the ECJ on this question in the context of Art 5(1) – see below.)

The applicability of Art 15 may therefore turn on whether the investor is the legal owner of the issuer's securities (making a contractual nexus easier to establish), or merely holds a beneficial interest. This, in turn, may depend on the rules of the exchange on which the shares are listed: in the UK, retail investors on an electronic exchange would have beneficial interests only, whereas in Germany investors obtain legal title (Geier, "*Comparison of the Electronic Securities Settlement Systems for the Secondary Securities Markets in Germany and England*" [2008] JIBLR 97). An issuer's decision on where to list its securities may therefore have a direct bearing on its ability to insulate itself from the application of Art 15.

Issuers might also be able to control their exposure to multiple jurisdictions by limiting the number of locations in which they publish their prospectus. But they will likely have less control when publishing any subsequent prospectus (eg, on a rights issue) which would need to be published wherever existing holders are domiciled. In such cases, issuers cannot rely on exclusive jurisdiction clauses to avoid litigating in multiple jurisdictions, because such clauses cannot oust a consumer's right to invoke Art 15 (see Art 17).

In summary, whilst the *Kolassa* decision is unclear as to whether secondary market purchasers can invoke Art 15, the upshot is that issuers will be incentivised to have direct contractual dealings with institutional counterparties only (against whom they can rely on exclusive jurisdiction clauses), in order to mitigate their risk of facing parallel proceedings in multiple jurisdictions.

CONTRACTS RULE INAPPLICABLE: BARCLAYS DID NOT "FREELY UNDERTAKE" OBLIGATIONS TO MR KOLASSA

Mr Kolassa also sought to invoke Art 5(1), which provided that in matters relating to a contract, a claimant could sue in the courts of the place of performance of the relevant obligation.

It is not clear what contractual obligation Mr Kolassa had identified as having to be performed in Austria (given that any payment obligation on the part of Barclays could only have been to pay Direktanlage in Germany). At any rate, the point appears to have been moot as the ECJ held that the required contractual relationship to invoke Art 5(1) was not present in this case.

The requirement of a contractual relationship is different for Art 5(1) as compared with Art 15: whilst the latter requires a contract to be "concluded" between the consumer and the defendant, the former merely requires the dispute to be a matter "relating to a contract", and does not require a contract to have been concluded (*Tacconi* (C-334/00)). However, it does require the identification of a direct obligation "freely assumed" between the parties – a contractual right against an intermediary, who in turn has a contractual right against the defendant, will not be sufficient (*Handte* (C-26/91)).

One would therefore expect that Art 5(1) would be held inapplicable by reason of the interposition of a third party (Direktanlage in this case) between Mr Kolassa and Barclays in the contractual chain. That appears to be the reasoning of Advocate-General Szpunar in this case, who considered that if Mr Kolassa had obtained legal title to the bonds on the secondary market and thus become subrogated to the position of the original subscriber, he would have been able to invoke Art 5(1), because he would have effectively become a contracting party with Barclays.

However, the ECJ appears to have taken the opposite view in its judgment. It does not appear to have focused on the fact that Mr Kolassa's interest in the bonds was indirect (even though this was an express part of the Austrian court's question) but merely addressed the question of whether a secondary market purchaser could be said to have a contractual relationship with an issuer. Contradicting the Advocate-General's opinion, the ECJ held that

> "an applicant who has acquired a bearer bond from a third party, without the issuer thereof having freely assumed an obligation towards that applicant … may not invoke jurisdiction under" Art 5(1).

The ECJ appears to have placed great emphasis on the need for the parties to have "freely assumed" obligations to one another, and held that this cannot be the case as between an issuer and a secondary market purchaser. On this reasoning (as argued above) parties could avoid the effect of Art 5(1) simply by making intra-group assignments of their contractual relationships with third parties.

It may be that by including the words "in circumstances such as those of the case in the main proceedings" the ECJ has qualified its decision as applying only to cases where there is an intermediary in the contractual chain. However, this fact does not form any part of the ECJ's express reasoning, which appears to apply to any secondary market transfer (and indeed any process of contractual succession not involving the consent of the other party). On a plain reading of the decision, it thus appears that only original subscribers of securities can rely on Art 5(1) as against an issuer. Whilst that is problematic for cases of contractual succession more generally, one can at least draw comfort from the fact that Art 5(1) will not apply where there is an exclusive jurisdiction clause.

TORT RULE APPLIED: DAMAGE SUFFERED IN MR KOLASSA'S HOME STATE

Mr Kolassa also argued that the Austrian court should have jurisdiction on the basis

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of the tort rule in Art 5(3). That rule, which can only be applied if Art 5(1) is inapplicable (see *Brogsitter* (C-548/12)), allows a claimant to sue in the jurisdiction where the "harmful event occurred", giving the claimant a choice between suing in the place where the events giving rise to the damage occurred and the place where the damage was suffered.

Again, there appears to be a divergence of approach between the Advocate-General and the ECJ. Advocate-General Szpunar noted the decision in *Kronhofer* (C-168/02) which held that a claimant could not establish jurisdiction in his home State under Art 5(3) merely because his assets were concentrated there, if the financial damage occurred in another Member State – to hold otherwise would not meet the objective of identifying a jurisdiction with a meaningful link to the dispute. However, because Barclays had published its prospectus in Austria, that was a sufficient event giving rise to damage to establish jurisdiction, in his view.

The ECJ took a different approach. It noted that there was no evidence to suggest that the prospectus was "originally drafted and distributed anywhere other than" the UK. By its use of the word "originally", the ECJ appears to have decided not to base its judgment on the fact that the prospectus was also published in Austria. There is little guidance in the judgment as to why the Attorney-General's reasoning was considered an insufficient basis to grant jurisdiction to the Austrian court.

Further, the ECJ distinguished Mr Kolassa's position from *Kronhofer*. In that case an Austrian claimant, having been persuaded to invest in speculative instruments, transferred funds to a German bank account, from where they were invested unsuccessfully. The ECJ held that the damage was suffered in Germany, and Mr Kronhofer could not therefore bring his claim in Austria. However, in Mr Kolassa's case, the ECJ held that the loss had occurred "directly" in Mr Kolassa's Austrian bank account. Whilst the judgments do not set out how the two claims were formulated, one can understand a difference between a claim for diminution in value of an investment (suffered in the place where the investment is held) (*Kronhofer*) and a claim that an investment should never have been made (where the loss is suffered in the bank account from which the investment is funded) (*Kolassa*).

But to hold that a claimant can sue in the jurisdiction where his relevant bank account was depleted, in the absence of any other link to that jurisdiction, would be to defeat the object of the Brussels Regulation, which (in addition to seeking predictability) aims to ensure that disputes are heard in jurisdictions which have a meaningful link to the matters in issue. Indeed, there is English authority to suggest that where a payment is procured that would not have been made but for a tort, the relevant place is that where payment was received, not the place from which it was made (*Sunderland Marine Mutual Insurance v Wiseman* [2007] EWHC 1460 (Comm)).

Nonetheless, the ECJ's approach in this case means that issuers are potentially subject to litigation in any jurisdiction in which an underlying investor (with whom the issuer may have no direct contractual nexus) has a bank account in which funds are depleted. Issuers are thus unable to predict where they might be sued, and may face parallel claims in multiple jurisdictions.

The ECJ appears to have anticipated this criticism, stating that an issuer

> "must, when he decides to notify the prospectus relating to that certificate in other Member States, anticipate that inadequately informed operators, domiciled in those Member States, might invest in that certificate and suffer loss".

It is not clear whether Barclays' decision to publish its prospectus in Austria was a condition of the ECJ's decision to grant jurisdiction to the Austrian court, but it appears not to be (as the ECJ did not adopt the Advocate-General's reasoning that events giving rise to the damage took place in Austria). Instead, by focusing on the location of the investor's bank account rather than where the prospectus was published (or where the funds were received), the ECJ has opened up the possibility that investors could sue in jurisdictions with no meaningful link to the dispute, causing the difficulties of unpredictability and multiplicity identified above.

ANOTHER OPPORTUNITY ON THE HORIZON?

Perhaps the most significant impact of the *Kolassa* decision is its application of Art 5(3) as regards financial damage. However, the ECJ will soon have another opportunity to consider this issue on a reference from the Dutch court in *Universal Music International Holding BV v Michael Tétreault Schilling* (C-12/15), which relates to alleged negligence by a Czech law firm, causing the Dutch claimant to have incurred a liability to its counterparty that was higher than expected. That liability manifested itself in Czech arbitration proceedings, which the claimant settled by making a payment from its Dutch bank account. It then sought to sue the Czech firm in the Netherlands.

The Dutch court has asked what approach it should take in distinguishing between "initial" or "direct" financial damage and "consequential" or "derived" financial damage, and what approach to take in determining where financial damage should be deemed to have occurred. Watch this space. ■

1 All the Articles cited in the judgment are materially identical to those in the recast Brussels Regulation 1215/2012 now in force.

Further Reading:

- Prospectus Liability: which law applies under Rome II? [2011] 4 JIBFL 195.
- Financial Transactions in the crossfire of Rome II [2011] 1 JIBFL 25.
- LexisPSL news: Brussels I and consumers: where does the loss occur?