KEY POINTS

- As a general rule, investors who purchase securities on the secondary market will not be subject to any exclusive jurisdiction arrangement that has been agreed between the issuer and the primary purchaser.
- The enforceability of an exclusive jurisdiction provision against a secondary purchaser will depend on whether the facts meet particular tests set out in a recent decision of the Court of Justice of the European Union.
- While the court's decision seeks to provide certainty, it requires each case to be determined on its own facts by the national court in which the proceedings are initially brought, even though this is unlikely to be the court that has been granted jurisdiction by the jurisdiction provision.

Feature

Authors Donny Surtani and Nick Chapman

When should a prospectus' jurisdiction provision bind a secondary purchaser of securities?

In the recent decision of *Profit Investment Sim SpA v Ossi* (C-366/13, 20 April 2016), the Court of Justice of the European Union (CJEU) considered the ability of a secondary market bond purchaser to bring proceedings in a manner that did not comply with the exclusive jurisdiction provision contained within the relevant prospectus. While the decision intends to provide guidance as to the circumstances in which a jurisdiction provision will be enforceable, its effect is that each situation is likely to turn on its own facts. This is likely to present difficulties for issuers when attempting to predict which jurisdictions they may possibly face claims in and gives rise to the risk of parallel claims in multiple jurisdictions.

THE FACTS

In 2004, the German commercial bank Commerzbank Brand Dresdner Bank AG (Commerzbank) issued a series of bonds pursuant to a publicly available prospectus that had been approved by the Irish Stock Exchange. The terms and conditions of the prospectus provided that the courts of England had exclusive jurisdiction to settle any dispute related to the bonds.

Redi & Partners Ltd (Redi), a financial intermediary licenced in the UK, subscribed to €2.3m of the bonds issued by Commerzbank. Redi then sold €1.1m of those bonds on the secondary market to Profit Investment Sim (Profit), an Italian registered company.

In 2006, Commerzbank gave notice of a credit event and cancelled the bonds held by Profit Investment. This caused Profit to enter compulsory administrative liquidation. Profit responded by bringing proceedings against Commerzbank, Redi and others, seeking to nullify the agreements through which it had purchased the bonds. The proceedings were brought in the Italian courts, despite the exclusive jurisdiction provision contained within the prospectus. The Italian courts referred the matter to the CJEU for a preliminary ruling as to the effectiveness of the jurisdiction provision.

The CJEU was also asked to consider issues relating to the connecting link between co-defendants and the impact of a contract being invalid on jurisdiction provisions, however these issues are not considered in detail here.

EXCLUSIVE JURISDICTION PROVISIONS AND ART 23(1) OF THE BRUSSELS REGULATION

Article 23(1) of EU Regulation 44/2001 (Brussels Regulation) provides that where parties have agreed that the courts of one of more member state will have jurisdiction to settle any disputes, that arrangement will be given effect to provided that one of three conditions is met, namely that the agreement:[1]

- is in writing or evidenced in writing (Art 23(1)(a));
- is in a form that accords with practices which the parties have established between themselves (Art 23(1)(b)); or
- so far as it relates to international trade or commerce, is in a form which accords with a usage of which the parties are or ought to have been aware, and which is widely known and observed in that particular trade or commerce (Art 23(1)(c)).

The conditions are intended to ensure that the parties genuinely consented to the exclusive jurisdiction arrangement. They are generally interpreted strictly, as they are a derogation from the standard position under the Brussels Regulation that defendants should be sued in the member state in which they are domiciled.

In *Profit*, the CJEU set out three circumstances under Art 23(1) in which a jurisdiction provision would bind a secondary purchaser of securities:

- First, it must be binding as between the issuer and the primary purchaser (here between Commerzbank and Redi), ie, their contract must contain an express acceptance of either the jurisdiction provision or the general terms contained within the prospectus. Assuming this initial acceptance is present, the provision will be further enforceable against a secondary purchaser provided that the contract between the primary purchaser and the secondary purchaser (here Redi and Profit) contains its own similar acceptance. In this regard, while there does not need to be any direct link between the issuer and the secondary purchaser, there must be a chain of written consent to the jurisdiction arrangement.
- If that is not the case, a secondary purchaser cannot generally be said to have agreed to what is provided for in

Feature

Biog box

Donny Surtani is a senior associate and Solicitor-Advocate at Herbert Smith Freehills LLP, focusing on international litigation and arbitration (particularly in financial and investment matters). Email: donny.surtani@hsf.com

Nick Chapman is an associate (New Zealand) in Dispute Resolution at Herbert Smith Freehills LLP in London. Email: nick.chapman@hsf.com

the contract between the issuer and the primary purchaser. However, a secondary purchaser will be bound by the initial jurisdiction agreement (assuming it is valid) if the secondary purchaser: (i) succeeded to the primary purchaser's rights and obligations under the relevant national law; and (ii) had the opportunity to acquaint itself with the prospectus containing the jurisdiction provision.

- Finally, the CJEU recognised that a secondary purchaser of securities could be bound by an exclusive jurisdiction provision if its inclusion in the prospectus could be regarded as an act that accords with a usage in international trade or commerce of which the parties are or ought to have been aware, and which is widely known or observed. In making this determination, the focus should be on the specific branch of international trade or commerce (rather than focusing on international trade or commerce generally, or the specific laws of any particular state).

Whether any of these circumstances are present in a particular case is to be determined by the national court in which the proceedings are initially brought and in accordance with its national law.

CONCERNS REGARDING THE ABILITY TO PREDICT THE ENFORCEABILITY OF AN EXCLUSIVE JURISDICTION PROVISION

While the CJEU's decision in *Profit* provides a reasonable degree of guidance as to when a jurisdiction provision will be enforceable, there is still likely to be considerable uncertainty for issuers who wish to predict the jurisdictions in which they may have to face claims from aggrieved investors. There are two primary causes of this uncertainty:

- The first is the lack of control and knowledge that an issuer faces when its securities are sold on the secondary market. In this regard, an issuer is unlikely to know whether a contract between the primary purchaser and the secondary purchaser contains an express acceptance of the jurisdiction arrangement. Equally, there is no ability for an issuer to know the manner in which a secondary purchaser may have succeeded to the primary purchaser's rights and obligations in regards to the initial contract, nor what standard practice is between those parties.
- The second is that the decision as to whether a jurisdiction provision is enforceable lies with the court in which the proceedings are initially brought, in accordance with its own national law. This court is unlikely to be the court granted jurisdiction by the jurisdiction provision, and in this regard the purpose of the provision is notably diminished at the first hurdle.

From the standpoint of commercial certainty and practicality, a more helpful decision would have been to hold that exclusive jurisdiction provisions that are valid between issuer and primary purchaser are always enforceable, even where the relevant instrument has been on-sold to a secondary purchaser. A decision of this nature would provide issuers and purchasers alike with greater transparency from the outset, rather than risking the important issue of jurisdiction being the subject of considerable preliminary deliberation.

However, even this approach would run into problems as regards consumers, upon whom jurisdiction clauses are only binding in very limited circumstances (Art 17). The consumer issue arose in *Kolassa v Barclays Bank* (C-375/13, 28 January 2015), but was not sufficient to establish jurisdiction because the CJEU held that there was no contractual nexus between the investor and the issuer. However, the CJEU in that case decided that the investor could bring a claim in his home jurisdiction in tort, on the basis that the damage was suffered in his bank account in Austria. That approach has been the subject of some critical commentary, as it creates the potential for issuers to face parallel claims in multiple jurisdictions (see for example Donny Surtani '*Prospectus liability: bracing for parallel claims in multiple jurisdictions*' [2015] 5 JIBFL 284 (May); and Matthias Haentjens and Dorine Verheij, '*Finding Nemo: Locating Financial Losses after Kolassa and Profit*' (2016) 31 JIBLR 346).

While decisions such as *Profit* and *Kolassa* seek to provide certainty as to the appropriate jurisdiction for claims brought by investors against issuers of securities, they risk having the opposite effect. This has led commentators to call for a special rule for prospectus liability claims, requiring such claims to be brought in the jurisdiction where the prospectus was approved (see Haentjens and Verheij, cited above).

The CJEU has recently taken a significant step to reduce uncertainty in such cases, by holding that in cases of financial damage, the focus should be on the place where the wrongful act occurred, not where damage was suffered: *Universal Music v Schilling* (C-12/15, 16 June 2016). That judgment distinguished *Kolassa* on its facts and appeared to recognise the need for certainty and predictability in questions of jurisdiction. That development should be applauded, and further moves in the direction of certainty encouraged. ■

1 The Brussels Regulation has since been replaced by EU Regulation 1215/2012 (Recast Regulation). The Recast Regulation applies to all proceedings commenced before the EU courts on or after 10 January 2015. While there are slight differences between the instruments (eg Art 23(1) of the Brussels Regulation is Art 25(1) of the Recast Regulation), the Recast Regulation stresses the importance of continuity, including in regards to interpretations of the instruments by the CJEU (Art 34). The Regulations will cease to apply post Brexit. It is not known what if any arrangements will replace it. Similar provisions may be negotiated. Another possibility is that the UK will become a party, with agreement, to the Lugano Convention 2007. If this were to occur, similar principles would continue to apply.

Further Reading:

- Prospectus liability: bracing for parallel claims in multiple jurisdictions [2015] 5 JIBFL 284.
- Prospectus liability: which law applies under Rome II? [2011] 4 JIBFL 195.
- LexisPSL Dispute Resolution news: Increasing the predictability of EU jurisdiction rules in tort cases.