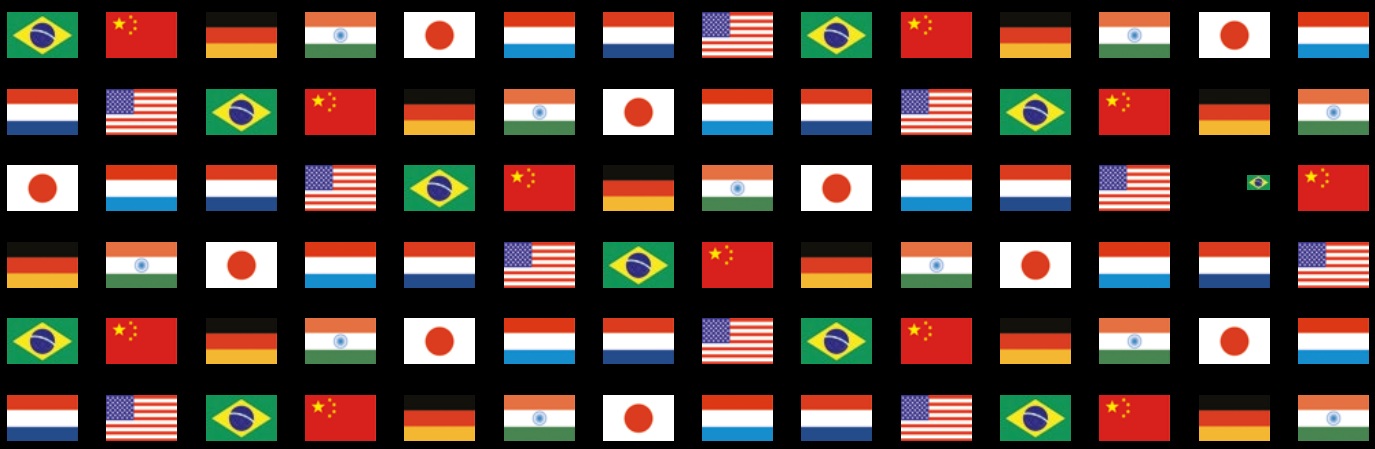
SECURITIES LITIGATION 2022

Contributing editor
Jason M Halper



LEXOLOGY
Getting the Deal Through

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Lexology Getting the Deal Through is delighted to publish the eighth edition of *Securities Litigation*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting the Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Jason M Halper of Cadwalader Wickersham & Taft LLP, for his continued assistance with this volume.

LEXOLOGY
Getting the Deal Through

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Global Overview

Jason M Halper, Adam Magid, James Orth, Victor Celis and Jayshree Balakrishnan

Cadwalader Wickersham & Taft LLP

Despite continued economic repercussions from the covid-19 pandemic, 2021 was an active year for securities litigation worldwide. In the United States, while there was an overall decline in securities class-action filings, there nonetheless was a steady stream of cases brought on an individual basis asserting violations of the Securities Exchange Act of 1934 (the Exchange Act) and the Securities Act of 1933 (the Securities Act), as well as an increase in certain sub-categories of securities class-action filings, including cases involving special purpose acquisition companies (SPACs). Moreover, US federal appellate courts and the Supreme Court issued significant securities law decisions in 2021, highlighted by the Supreme Court's decision in *Goldman Sachs Group, Inc v Arkansas Teacher Retirement System*, which is likely to create a new front in certification of putative securities class actions. Globally, there were significant legislative and judicial developments in the European Union, Luxembourg, China and Japan, potentially expanding opportunities for private litigants to assert securities claims in those jurisdictions.

US developments

Trends

According to a report by NERA Economic Consulting, new securities class-action filings in the United States declined for the second consecutive year, falling from 321 in 2020 to 205 in 2021 (McIntonsh, J and Starykh, S, NERA Economic Consulting, 'Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review', 25 January 2022). The 2021 total was over 50 per cent below annual filings from 2017 to 2019, and represented the lowest level of new filings since 2009. The aggregate decline, however, was primarily fuelled by a dramatic reduction of merger-objection filings, from 103 in 2020 down to only 14 in 2021. The pace of section 10(b), section 11 and/or section 12 filings in other contexts, by contrast, was largely static, falling from 209 in 2020 to 187 in 2021. Thus, the significance of the decline should not be overstated, as some commentators have noted the trend of merger-objection suits being filed in individual (as opposed to class) actions, which are not captured in the data.

NERA also tracked the incidence of certain event-driven categories of filings in 2021. For example, in 2021, 20 class action filings involved claims relating to covid-19, a decline from 33 filings in 2020. Of these, 81 per cent involved allegations of misleading future performance or missed earnings guidance. Another key area involved filings relating to SPACs, which increased to 24 cases from only one in all of 2020. The most common allegation in SPAC-related cases concerned merger-integration issues, occurring in all but one of the cases; missed earnings guidance was the second most common allegation, occurring in 11 cases. Other topic areas where there were notable changes in the number of filings included cannabis (only one filing in 2021, as compared to six in 2020), cybersecurity breach (five in 2021 versus three in 2020), and the environment (one in 2021 versus five in 2020).

NERA reported that 239 securities class actions were resolved in 2021, down from 312 in 2020 and the lowest recorded level since 2015. Again, however, this decline was largely attributable to a reduction in merger-objection dismissals, from 123 in 2020 to only 24 in 2020. In non-merger objection cases, both dismissals and settlements increased from the prior year, from 116 to 129 and from 70 to 82, respectively. Of settled cases, the average settlement value declined by over 50 per cent, from US$44 million in 2020 to US$21 million in 2021. That decline coincided with a greater proportion of settlements of less than US$10 million (59 per cent in 2021 versus 44 per cent in 2020) and a lower proportion of settlements greater than US$100 million (4 per cent in 2021 versus 9 per cent in 2020). The top class-action settlement of 2021 involved defendant Snap, Inc – developer of Snapchat – for a total value of US$154.7 million.

Notable decisions

US federal courts issued a number of significant decisions in 2021 clarifying the scope and reach of private claims under the federal securities laws. Foremost among those decisions was the Supreme Court's decision in *Goldman Sachs Group, Inc v Arkansas Teacher Retirement System*, vacating a decision of the US Court of Appeals for the Second Circuit that affirmed certification of a securities fraud class action. At issue in *Goldman* was the fraud-on-the-market (or *Basic*) presumption afforded to plaintiffs in an efficient market, and, specifically, whether the defendants had successfully rebutted the presumption so as to defeat class certification. To obtain class certification, plaintiffs must satisfy the requirements of Federal Rule of Civil Procedure 23, including (for any action seeking damages), a showing that 'questions of law or fact common to class members predominate over any questions affecting only individual members'. Ordinarily, plaintiffs bringing a section 10(b) claim would face a significant challenge in meeting this 'predominance' requirement: each putative class member may have purchased the security for different reasons, precluding a finding of predominance due to individualised issues of reliance – one of the elements of a section 10(b) claim. In the 1988 decision *Basic v Levinson*, however, the Supreme Court recognised the 'fraud-on-the-market' theory of reliance that makes section 10(b) class actions possible: when a stock trades in an efficient market, courts may presume that all investors rely on the integrity of the market price as reflecting all material public information, including any fraudulent statements. Where established, the *Basic* presumption alleviates plaintiffs' need to show reliance on a case-by-case basis, allowing adjudication as a class action.

To invoke the *Basic* presumption a plaintiff must prove that: (1) the alleged misrepresentation was publicly known; (2) it was material (ie, significant to a 'reasonable investor'); (3) the stock traded in an efficient market; and (4) the plaintiff traded the stock between the time the misrepresentation was made and when the truth was revealed. Once plaintiffs have made this threshold showing, however, a defendant can rebut the presumption by demonstrating 'that the misrepresentation in fact did not lead to a distortion of price', which may be accomplished by any showing that 'severs the link' between the alleged misrepresentation and either the price paid by the plaintiffs or their decision to trade at that price.

In *Goldman*, the Supreme Court directed the Second Circuit to consider the 'generic' nature of the alleged misrepresentations in assessing whether the defendants had successfully rebutted the *Basic* presumption of reliance for the purposes of the plaintiff's claim under section 10(b), and therefore, whether class certification was appropriate. In so ruling, the Court held that courts at class certification must consider 'all evidence relevant to price impact', which is a prerequisite to invoking the fraud-on-the-market presumption afforded to plaintiffs in an efficient market, 'regardless whether that evidence overlaps with materiality or any other merits issue'. The Court also held that a defendant seeking to rebut the fraud-on-the-market presumption of reliance bears the burden of persuasion to show, by a preponderance of the evidence, that a misrepresentation did not in fact lead to a distortion of the price of a security.

The decision is likely to create a new front in the class certification battleground. Notably, *Goldman* clarifies that the materiality of alleged misrepresentations is relevant to a showing of price impact, and a defendant is entitled to introduce materiality evidence to rebut the *Basic* presumption at the class certification stage – a conclusion that many courts had previously rejected. And although preserving the fraud-on-the-market presumption, *Goldman* confirms that plaintiffs and defendants are on nearly equal footing in establishing whether the presumption applies (through evidence of price impact or lack thereof), subject to a preponderance of the evidence standard. Accordingly, the battle over the *Basic* presumption – already one of the main events in securities class-action litigation – is likely to get even more heated in the wake of *Goldman*.

US Courts of Appeals also issued several important decisions with implications for class certification of securities cases. In *Donelson v Ameriprise Financial Services, Inc*, the Eighth Circuit ordered class-action allegations in a putative securities fraud class action stricken on the pleadings under Rule 12(f) of the Federal Rules of Civil Procedure, and directed the matter to arbitration. The Court explained that it is appropriate to strike class allegations under Rule 12(f), prior to a motion for class certification, if it is 'apparent from the pleadings that the class cannot be certified'. The Court concluded that was so in *Donelson* because the plaintiff's pleadings demonstrated that individualised determinations would have to be made with respect to multiple elements of a securities fraud claim, including whether each of the various defendants (including the plaintiff's individual investment adviser and officers of the defendant company) made material misrepresentations, whether class members relied on the misrepresentations, and whether economic harm resulted from the misrepresentations. Given its conclusion that the class could not be certified, the Court ordered the plaintiff's securities claims to arbitration pursuant to an arbitration clause entered into between the plaintiff and the investment adviser, which covered 'all controversies' except a 'putative or certified class action'. The decision is significant not only for its broad application of an arbitration clause to federal securities fraud claims, but as a rare appellate-level endorsement for striking class allegations under Rule 12(f) – which permits a court to strike from a pleading 'an insufficient defense or any redundant, immaterial, impertinent, or scandalous matter' – prior to class discovery and a motion for class certification.

In *Ford v TD Ameritrade Holding Corp*, the Eighth Circuit reversed a district court order certifying a class action alleging that TD Ameritrade committed securities fraud by failing to comply with the duty of best execution – which requires a broker-dealer to seek for its customer's trade orders 'the most favorable terms reasonably available under the circumstances' – in executing customer orders. The Court concluded that the plaintiffs' proposed class of TD Ameritrade customers did not satisfy the Rule 23 requirement that 'questions of law or fact common to class members predominate over any questions affecting only individual members'. The Court explained that, unlike a typical stock-drop case, loss caused by violation of the duty of best execution can only be determined by comparing: (1) the price at which the customer's trades were executed; and (2) a better price allegedly available from an alternative trading source. A best execution case thus requires proof of the circumstances surrounding each trade, the available alternative prices, and the state of mind of each investor when placing his or her order. The Court held that, because injury could not be presumed across the putative class (let alone for each trade by each putative class member), common issues did not predominate over individualised ones. The decision deals a blow to securities class actions based on violations of a broker's best execution obligation and highlights the difficulties investors face in certifying securities fraud claims outside a typical disclosure-based stock-drop case.

And in *Aly v Valeant Pharmaceuticals International Inc*, the Third Circuit held that *American Pipe* tolling – a doctrine that suspends (or 'tolls') the running of the statute of limitations applicable to the claims of potential class members while a putative class action is pending –applies to individual actions filed in advance of a district court's class-certification decision. Prior to the decision, potential class members seeking to assert individual claims would have to file either shortly after commencement of the class-action suit (within the limitations periods applicable under the Securities Act and the Exchange Act, respectively), or else wait for a court to issue its decision on class certification, a process that often takes years. Under *Aly*, however, class members' claims also are tolled prior to (as well as after) a class certification decision, meaning that they now are able to bring concurrent individual suits at any point prior to resolution of class certification without statute of limitation concerns.

Federal courts also weighed in on the threshold question of who has standing to bring private claims under the federal securities statutes in various situations. In P*irani v Slack Technologies, Inc*, the Ninth Circuit held that investors who purchase stock in a 'direct listing' – in which pre-existing shares are sold to the public without underwriters – may bring claims based on alleged misrepresentations in a registration statement, even if they cannot demonstrate that they acquired registered shares. In a direct listing the company does not issue any new shares and instead files a registration statement 'solely for the purpose of allowing existing shareholders to sell their shares' on an exchange. The Court explained that sections 11 and 12(a)(2) of the Securities Act permit such claims, even by purchasers of unregistered shares, because, in a direct listing, a single registration statement allows both registered and unregistered shares to be made available to investors. Further, in the Court's view, negative consequences would result from a contrary ruling, including incentivising issuers to conduct direct listings, instead of underwritten initial public offerings (IPOs), to evade liability for 'overly optimistic' registration statements, and upending investors' ability to seek redress under laws in place for almost 90 years.

In *Aiello v Brown*, the Second Circuit clarified that holders of unexercised pre-emptive rights to acquire securities – absent 'irrevocable liability' to acquire a security – lack standing to assert section 10(b) claims. *Aiello* illustrates that, at least according to one Second Circuit panel, it is inappropriate to endorse novel expansions of the section 10(b) 'purchase' or 'sale' requirement. The Court will strictly construe the definitions contained in section 3(a) of the Securities Exchange Act and limit standing to persons who 'commit' to transactions in those specific, enumerated instruments.

In *In re Bibox Group Holdings Ltd Securities Litigation*, a district court in the Second Circuit dismissed a putative class action alleging registration violations under securities laws against a cryptocurrency issuer and exchange, holding that the plaintiff lacked standing to assert class claims based on crypto-assets he did not purchase and did not timely file suit. While a win for the defendants, the decision serves as a reminder that the securities laws apply in full force to cryptocurrencies

that qualify as securities, and the failure to register cryptocurrencies, as with any other security, may expose crypto-issuers and exchanges to class action claims.

Meanwhile, the First Circuit endorsed a broad view of the extraterritorial reach of the federal securities laws, cementing a circuit split with the Second Circuit. In *SEC v Morrone*, the First Circuit held that the federal securities laws apply to securities transactions as long as 'irrevocable liability' – the point at which parties become legally bound to carry out the transaction – occurs in the United States. The Court thus joined the Ninth Circuit in rejecting the Second Circuit's more defendant-friendly approach to extraterritoriality, under which a defendant may avoid liability by showing that the claims 'are so predominantly foreign as to be impermissibly extraterritorial'. Until the Supreme Court resolves this circuit split, plaintiffs asserting securities claims involving foreign transactions may choose to steer clear of the Second Circuit, opting for circuits that have rejected such fact-intensive defences.

Finally, several Courts of Appeal issued decisions expounding on the pleading and evidentiary requirements for a section 10(b) securities fraud claim. In *Altimeo Asset Management v Qihoo 360 Technology Co Ltd*, the Second Circuit reinstated section 10(b) claims premised on the defendants' alleged failure to disclose in proxy materials a plan to relist the post-merger company on a foreign exchange. According to the Court, the plaintiffs plausibly alleged that the statement in the proxy materials that the company did 'not have any current plans' to relist was not accurate, given that only 16 months passed between close of merger and the company's subsequent relisting on the Shanghai Stock Exchange, as well as contemporaneous news articles from Chinese publications reporting a plan to relist. In so ruling, the Court parted ways with the district court, which concluded that the proxy materials were truthful in that they disclosed the 'possibility' of a relisting (along with the possibility of 'plans' or 'proposals' for other non-specific corporate events and transactions), and the plaintiffs failed to allege a 'concrete' pre-merger relisting plan so as to render the disclosure misleading. The Second Circuit, by contrast, found the swift timing of the subsequent relisting and contemporaneous news reports about a relisting plan a sufficient basis to infer that a 'concrete' plan to relist existed at the time. The decision upends what was a developing consensus among district courts that, absent detailed and direct allegations of a 'concrete' pre-take private plan to relist (as opposed to circumstantial indications of such a plan, as in *Altimeo*), a disclosure about the 'possibility' of a future relisting will suffice to protect the issuer from section 10(b) liability if such a plan eventually materialises.

In *Karth v Keryx Biopharmaceuticals, Inc*, the First Circuit affirmed entry of judgment for the defendants in a putative class action asserting violations of section 10(b) based on a pharmaceutical company's alleged understatement of risks associated with its reliance on a single third-party manufacturer for the only drug it produced. In so ruling, the Court invoked a 'Grand Canyon' metaphor for a company's obligation to describe risks as active or imminent, as opposed to theoretical: 'one cannot tell a hiker that a mere ditch lies up ahead, if the speaker knows the hiker is actually approaching the precipice of the Grand Canyon.' In this case, however, the Court held that the defendant's risk disclosures – which stated that it 'could experience a loss of revenue' if its supplier failed to perform – were not misleading, given the absence of a 'widely-accepted certainty of failure' at the time. Rather, the situation was in theory 'merely risky', akin to approaching a 'ditch', but the risk had not matured to the point where it was active or imminent (ie, the Grand Canyon).

And in *In re Volkswagen 'Clean Diesel' Marketing, Sales Practices, and Products Liability Litigation*, the Ninth Circuit reversed a district court order denying summary judgment to Volkswagen AG and subsidiaries in a long-running securities fraud suit premised on the automobile manufacturer's alleged use of 'defeat devices' to skirt emissions tests. The Court denied the plaintiff the *Affiliated Ute* presumption of reliance – a substitute at the motion to dismiss and class certification stages for the otherwise required direct proof of reliance in claims asserted under section 10(b) involving 'primarily a failure to disclose'. The Court reasoned that the complaint alleged that plaintiff 'reviewed and relied upon' numerous affirmative misstatements regarding Volkswagen's compliance with environmental regulations, and therefore the case was not primarily based on alleged omissions. *Volkswagen* thus limits availability of the powerful *Affiliated Ute presumption* to cases that 'primarily allege omissions', where reliance is nearly impossible to prove, casting doubt on its application in 'mixed cases' involving both affirmative misstatements and omissions. Questions will persist, however, as to where to draw the line between cases that 'primarily' involve omissions, and those that do not.

Non-US developments

Outside the United States, the enactment of class-action statutes is expected to have significant effects on collective securities claims globally. In late 2020, the European Union issued a Directive on Representative Actions, which allows certain qualified entities to bring representative actions on behalf of consumers across Europe and assert claims for damages. While the directive, described as a 'new deal for consumers,' does not specifically address securities claims, certain commentators have opined that it will enable shareholder groups to advance claims stemming from faulty disclosures in offering documents. The directive requires that EU member states implement the directive by the end of 2022, with the statute becoming effective in each member state by June 2023.

In January 2021, the Parliament of Luxembourg enacted legislation which recognises the issuance of dematerialised securities (securities that exist solely in electronic form rather than in the traditional physical paper form of physical certificates) using distributed ledger technology – including blockchain – and expands the list of entities permitted to act as an account keeper for unlisted debt securities. This new framework allows the entire issuance and circulation process of new securities to take place using blockchain or other distributed ledger technology. As issuers begin utilising blockchain in the issuance of securities, it will be worth monitoring for litigation surrounding this new form of issuances.

Securities litigation also continued to evolve in China in 2021. The 2020 amended Securities Law gave rise to a new representative action mechanism and new provisions regarding investor protection and civil litigation. An ordinary representative action under the Securities Law is a collective action in which there are more than 10 individuals as plaintiffs, between two and five of which are elected as representatives, and the existence of misconduct is preliminarily proved by the satisfaction of at least one of the pre-filing conditions (such as evidence of misconduct through an administrative penalty, disciplinary measure imposed by an exchange, or a voluntary confession). In contrast, a special representative action is a collective action in which a designated investor protection agency – currently the China Securities Investor Services Center or the China Securities Investor Protection Fund Corporation Limited – commences the action and acts as representative for a minimum of 50 plaintiffs. Courts continue to interpret and apply the 2020 Securities Law in the context of both forms of representative action. With the number of securities litigation cases accepted by Chinese courts increasing each year, Beijing established a new specialist court for financial disputes. Specialist panels for securities litigation trials have recently been established in other regions of China, as well.

In Japan, 2021 brought an expansion of underwriter liability in IPOs. In late December 2020, the Supreme Court of Japan held that an IPO lead underwriter could be held liable for damages arising from material misstatements in a securities registration statement. The decision was significant because it created an additional duty for underwriters: to

investigate and confirm the accuracy of financial accountings in registration statements even if they were already certified by an auditor.

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GENERAL FRAMEWORK

General climate

1 Describe the nature and extent of securities litigation in your jurisdiction.

Securities litigation is a recent and evolving practice in Brazil, which was ignited when the now famous and long-running *Operation Car Wash* investigation revealed one of the largest corruption scandals in history involving Brazil's state-run oil company Petrobras. When the company's malfeasance was uncovered, investors who had suffered losses resulting from years of misinformation initiated class and individual actions in the United States and the Netherlands, as well as arbitrations before the Market Arbitration Chamber at Brazil's Stock Exchange (B3).

Since 2016, a significant number of cases followed in view of alleged misinformation from other Brazilian corporations, such as CVC, Vale, BRF, JBS and Embraer.

Importantly, since these companies provide for an arbitration clause on the relevant by-laws, such disputes have been mostly referred to arbitration to be resolved. Owing to the confidentiality applying to arbitration proceedings, the docket of these cases are not publicly available and updates are only disclosed by the corporations when there are new and important developments. In addition, because these securities litigation cases are still ongoing, no precedents have been established yet.

Courts and time frames

2 What experience do the courts in your jurisdiction have with securities litigation? Are there specialist courts for securities disputes? What is the typical time frame for securities litigation in your jurisdiction?

Arbitration

Jurisdiction

Most of the publicly held corporations in Brazil provide for an arbitration clause in the relevant by-laws. Usually, the arbitration clause establishes that all disputes involving the corporation, its shareholders, officers, directors and supervisory board members shall be settled by binding arbitration under the rules of the Market Arbitration Chamber, in matters concerning the relevant party's quality of issuer, shareholder, officer or director and relating to Law 6,385/1976 (the Capital Markets Law), Law 6,406/1976 (the Corporations Law), the corporation's by-laws, the regulations enacted by the National Monetary Council, the Central Bank of Brazil and the Securities Exchange Commission, and all other rules applicable to the capital markets. Consequently, individual or multi-party securities litigation are usually settled by means of arbitration proceedings.

Time frame

The usual time frame for an arbitral award is two to five years.

Securities class action

Jurisdiction

The state courts have jurisdiction over securities litigation class action cases. Usually, such disputes are held before courts specialised in dealing with civil matters in general, and which have limited experience in securities cases.

In addition, there are precedents of individual and collective claims that were filed before state courts and dismissed for lack of jurisdiction. In all such cases, the defendant is a corporation that has an arbitration clause in its by-laws. Accordingly, the court considered that the dispute had to be brought before the arbitration chamber. Owing to such dismissals, a few cases of tentative collective arbitration have been filed, none of which has had a final result yet.

Time frame

The usual time frame for a district court ruling is five years.

Government regulation and enforcement

3 What is the relationship between private securities litigation and government regulation and enforcement in your jurisdiction?

The Brazilian Securities and Exchange Commission (CVM) is the federal government's principal regulatory and enforcement agency with respect to securities activities in the national capital markets. The CVM is entitled, among other things, to promote the expansion and efficient functioning of the capital markets, protect investors from misinformation, irregular issuance of securities, illegal acts of controlling shareholders, officers and board members, as well as assure investors with access to material information about the securities and respective issuers.

CVM enforcement actions involving public corporations vary in many aspects from private securities actions and usually there is no overlap in responsibilities involving those claims. Although the object of CVM investigations and private securities claims can be related, the CVM has a much wider array of charges it can level, as well as the power to seek broader and potentially more devastating remedies than what may be obtained in private securities litigation. For example, an enforcement action may result in the imposition of large corporate penalties, restrictive corporate governance structures, disgorgement, temporary or permanent restrictions on an individual's ability to serve as an officer or director, suspension of the register of an issuer, etc. In addition, while the CVM itself is an administrative agency that does not seek criminal remedies, its investigations are sometimes referred to criminal authorities with even broader investigative powers.

CLAIMS AND DEFENCES

Available claims

4 | What types of securities claim are available to investors?

Because private securities litigation is still incipient in Brazil, the basic and most common claim available to investors is for misrepresentations or omissions in corporate statements of a publicly held company (which can include from offering documents to routinely material information disclosed by the corporation). In theory, any instruments, disclosures and transactions can generate litigation provided that there was a material misinformation in any of such acts.

Offerings versus secondary-market purchases

5 | How do claims (or defences to claims) arising out of securities offerings differ from those based on secondary-market purchases of securities?

The claim does not differ whether the misinformation was conducted during an initial public offering or secondary market transactions.

Public versus private securities

6 | Are there differences in the claims or defences available for publicly traded securities and for privately issued securities?

A private corporation has a contractual nature and is primarily ruled by statutes grounded in the freedom of contract that govern the private interests of the company's shareholders. A publicly held corporation has a clear-cut institutional nature, which causes a range of administrative controls to be imposed over its organisation and operations. Thus, while a private corporation is based on the private interests of the shareholders that incorporated them, the protection of the collective interest prevails in a publicly held corporation.

Accordingly, the regulations over private and publicly held corporations differ in many respects, especially regarding securities litigation over misinformation. The main purpose of Law 6,406/1976 (the Corporations Law) is to regulate the corporate relationship established between shareholders and the agency relationship established between the controlling shareholder and officers, as well as to remedy mismanagement. Law 6,385/1976, on the other hand, establishes the duties of a public company as an institution, among which reside the duty to disclose truthful, complete and accurate information to the investing public in view of the collective interest.

Primary elements of claim

7 | What are the elements of the main types of securities claim?

The three basic elements of a tort are: illicit act, economic loss and loss causation. Depending on the matter under analysis, it might be that an 'intent to defraud' is also a required element of liability.

Thus, to establish liability in a securities claim, a plaintiff must plea and prove:

1 illicit act: material misstatement or omission in violation of duty to disclose;
2 economic loss: actual damages suffered by investor; and
3 loss causation: loss was caused by the misinformation.

Primary defences

8 | What are the most commonly asserted defences? Which are typically successful?

The most common asserted defences in a misinformation private securities litigation are the following:

1 lack of standing by the plaintiffs;
2 lack of specific statutory provision in the Corporations Law establishing a corporation's liability for misinformation before investors, although the claim could be grounded both on civil liability, in general, and on Law 7,913/1989 that established corporate liability for misinformation to investors;
3 officers and directors would be proper defendants to respond to a misinformation private claim based (solely) on the Corporations Law;
4 defendant did not engage in an actionable illicit act;
5 plaintiffs did not establish that the defendant's misrepresentation actually affected the stock price; and
6 plaintiffs should be required to prove reliance or scienter.

These defences are still being tested in private arbitration claims and no solid result has been provided yet.

Materiality

9 | What is the standard for determining whether the misstated or omitted information is of sufficient importance to be actionable?

Material information means any decision of a controlling shareholder, deliberation of the general shareholders' meeting or any corporate bodies of a publicly held corporation, or any other act or fact of managerial, technical, business or economic financial nature that occurred or related to its businesses that may affect in a measurable way:

- the market price of securities issued by the publicly held corporation; or
- the decision of the shareholders and other investors to buy, sell or hold securities issued by such publicly held corporation and to exercise any rights arising from the ownership of such securities.

To determine whether the misinformation is of sufficient importance to be actionable, plaintiffs usually test whether there was a price decline when the truth was revealed to the market. A showing of price impact usually refers to the effect that the misrepresentation caused on a stock price.

Scienter

10 | What is the standard for determining whether a defendant has a culpable state of mind to support liability? What types of allegation or evidence are typically advanced to support or defeat state-of-mind requirements?

Under Brazilian law, this is a matter that might raise controversy.

Plaintiffs could argue that a company has strict liability for all the acts of management performed by its officers, without prejudice to the company's right of return against those officers. Accordingly, an intent to defraud the individual who acted on behalf of the company would not be required as an element to establish corporate liability. This is because the acts of the legal entity are solely aimed at fulfilling its corporate purpose and must be analysed with respect to whether or not it violates the law, unlike the individual who acts under the influence of psychological ambiguities inherent to human nature.

Defendants, however, could argue that the plaintiffs must plea and prove, with a high degree of specificity, the conscious intent to deceive, manipulate or defraud. Accordingly, in such case plaintiffs would need to state with particularity the facts that give rise to a strong inference that the defendant acted with the required state of mind. If that was the case, plaintiffs usually rest upon the premise that the defendants could not refute scienter by virtue of the positions they hold within the company. These inferences permit the court to impute knowledge of facts critical

to a business's core operations to a company's key officers because of the nature of the statements made and the level of the officers' involvement with the company. Following the previous example, for instance, although a plaintiff could attempt to establish intent through a person's position in a company, the defendants could argue that the title or job functions of an employee do not, standing alone, demonstrate awareness.

Reliance

11 | Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

Under Brazilian tort law, there is no statutory requirement of pleading and proving reliance.

Causation

12 | Is proof of causation required? How is causation established? How is causation rebutted?

Plaintiffs must plead and prove the causal nexus between the loss and the misinformation, that is, make a showing of the proximate causal link between the alleged misinformation and the economic harm.

This is a question of evidence subject to proof by expert witnesses who will opine on whether there was a loss causation. The use of the event-study econometric methodology is the most common way to show whether the drop in the stock price is the result of the misrepresentation or any other intervening causes. To rebut loss causation, defendants usually show evidence that exogenous factors were responsible for the loss.

Other elements of claim

13 | What elements or defences present special issues in the securities litigation context?

Not applicable.

Limitation period

14 | What is the relevant period of limitation or repose? When does it begin to run? Can it be extended or shortened?

The limitation period concerning securities class actions to remedy unlawful conduct is five years, as opposed to three years in cases of individual direct actions, as is the case in arbitrations. The limitation period starts to run when the unlawful conduct takes place, provided that the injured party was aware of the unlawful act, resulting damages and causal nexus. However, in the case of civil actions for damages derived from unlawful conduct that are also subject to criminal actions or investigations – and provided that a criminal action or investigation is in fact initiated – the limitation period starts to run only after such actions or investigations are concluded. The Superior Court of Justice has consistently reaffirmed the general rule that the limitation period cannot start to run before an injured party becomes aware of the unlawful conduct (or aware of its harmful effects).

REMEDIES, PLEADING AND EVIDENCE

Remedies

15 | What remedies are available? Do any defences present special issues in the context of securities litigation? What is the measure of damages and how are damages proven?

The most common remedy available for a securities litigation claim is damages.

The most simple and efficient method to assess damages is to conduct an event-study, which is an econometric analysis often used in securities claims. The core function of an event study is to measure the magnitude and nature of a change in the price of a company's stock and the so-called unexpected returns that were caused by the misinformation.

The ultimate goal of the event studies analysis is to show that a misrepresentation that affected the integrity of the stock's market price also has caused the plaintiff an economic loss. In effect, the measure of damages is the amount by which the misinformation inflated the price paid by the plaintiff.

Defendants also make use of the event-study methodology – but to show that the misinformation was not the cause of the decline of the stock value and rather reflected changed economic circumstances or investor expectations, new industry-specific or firm-specific facts, conditions or other events – which taken separately or together account for some or all of that lower price.

Pleading requirements

16 | What is required to plead the claim adequately and proceed past the initial pleading?

The general pleading requirements for a civil claim are: parties' standing and plaintiffs' lawful interest in the subject of the action.

Active standing relates to the capacity of the plaintiff to bring a claim before the court. In the specific case of securities litigation, the plaintiff must show that they were either a purchaser or a seller of the security. Passive standing is the requirement that the defendant is a proper party to respond to the plaintiff's claims.

A lawful interest in the subject of the action is a showing, by the plaintiff, that they are entitled to seek judicial protection for their substantive right that was violated or is at risk to be violated.

Plaintiffs must also furnish information on an adequate cause of action and a request for remedies as provided by the law.

Procedural defence mechanisms

17 | What are the procedural mechanisms available to defendants to defeat, dispose of or narrow claims at an early stage of proceedings? What requirements must be satisfied to obtain each form of pretrial resolution?

The most common arguments to dismiss a claim at an early stage of the proceeding are: the plaintiff's or defendant's lack of standing or lawful interest; the plaintiff's failure to adequately plead the complaint; lack of jurisdiction of the court or arbitration; any irregularities on the service of process; or the duality of procedures with the same object and parties. Each of these claims must be pleaded and proven with a high degree of specificity to obtain a favourable court order.

Evidence

18 | How is evidence collected and submitted to the court to support securities claims and defences in your jurisdiction? What rules and common practices apply to the introduction of expert evidence and how receptive are courts to such evidence?

Under Brazilian law, the courts have a lot of power in the conduct of judicial procedures. The rules of evidence were designed for the court to be the ultimate beneficiary of discovery produced for the resolution of the dispute.

More specifically, expert witness testimony is produced at the discretion of the court. The basic rule of expert witness' designation is that the court, rather than the parties, is entitled to appoint an expert

witness when the showing of a fact depends on a technical analysis. The court is also responsible for delimitating the extent of the expert witness' analysis.

There is some flexibility when the parties may consent to the appointment of a common expert. In addition, the court is allowed to waive its right to appoint an expert witness if the parties present technical or scientific reports that sufficiently provide clarification about the matter under dispute.

Finally, each of the parties is allowed to appoint a technical assistant to produce and present an analysis about the dispute, in addition to supervising the court's appointed expert; and present questions that must be answered by the court's expert witness, either in its report or in testimony.

In arbitration proceedings, the rules are more open and flexible. The arbitrators are expected to assess the significance of each party's evidence and measure the influence of each of its elements in the case, being further able to decide based upon the evidence produced by each of the parties individually. In addition, because arbitrators are attorneys or scholars specialised in financial and corporate matters, the production of evidence of this kind is a subject that is dealt more easily in an arbitration.

In any case, under Brazilian law, there is no discovery procedure. If a party to proceedings requires disclosure of specific documents or information by the other party, it must make such a request to to the court or to the arbitrators.

LIABILITY

Primary liability

19 | Who may be primarily liable for securities law violations in your jurisdiction?

The primary liability for a securities claim based on misinformation lies with the corporation.

The corporation has an institutional nature and several bodies to which power and obligations are assigned to, who ultimately decide on what the company will do and represent it. In other words, the acts performed by the company's administration are binding and deemed as the acts of the company itself. This organic relationship is established by the force of the law.

In a securities claim of misinformation, the wrongful act attributed to the corporation is considered an ordinary act of management, and whether officers acted with intent, negligence or in violation of the law or the company's by-laws, is irrelevant. The legal obligation to disclose truthful and complete financial statements is a non-delegable duty that must be performed by the company's officers, as a body of the company, for which it must be held primarily liable.

This primary liability is concurrent and does not depend on the personal liability incurred by the officers. Such liability also does not prejudice the corporation's right of return against those officers.

Secondary liability

20 | Are the principles of secondary, vicarious or 'controlling person' liability recognised in your jurisdiction?

The breach of a duty to disclose is a violation of the law by the corporation itself, for which it must be held primarily liable. Notwithstanding this, the officers' or controlling shareholders' secondary liability is recognised when they acted with intent, negligence or in violation of the law or the company's by-laws. A claim of such nature can be brought by the corporation or by its shareholders on a derivative action.

Claims against directors

21 | What are the special issues in your jurisdiction with respect to securities claims against directors?

Officers and directors are liable for damages that were caused as a result of negligent or wilful conduct, or violations of the law or the corporation's by-laws. Those claims based on fiduciary duty breaches are not actionable under the private securities litigation framework. Rather, it is incumbent on the corporation or its minority shareholders to bring a derivative action to seek indemnification on behalf of the corporation.

Claims against underwriters

22 | What are the special issues in your jurisdiction with respect to securities claims against underwriters?

Not applicable.

Claims against auditors

23 | What are the special issues in your jurisdiction with respect to securities claims against auditors?

Not applicable.

COLLECTIVE PROCEEDINGS

Availability

24 | In what circumstances does your jurisdiction allow collective proceedings?

A collective action for the protection of individual homogeneous rights may be filed before the courts. In such case, a decision of the judge will produce erga omnes effects.

There is a Brazilian law (the Securities Class Action Law) that specifically provides for the possibility of the public prosecutor's office (PPO) to bring a securities class action on behalf of investors. Essentially, it is used as a tool to safeguard Brazil's securities market and to protect minority investors from unlawful conduct, including but not limited to, fraud and manipulation, insider trading and not providing material or legally required material information or providing false or misleading statements.

The Securities Class Action Law establishes that, notwithstanding individual actions, the PPO may bring public civil actions to halt such unlawful conduct or provide compensation to injured investors. Arguably, other entities also have standing pursuant to the general rules of public civil actions, especially civil associations that have among their objectives the protection of investors, and have been established for over one year.

Reliance, causation and damages

25 | Can reliance, causation and damages be determined on a class-wide basis, or must they be assessed individually?

Reliance

There is no statutory requirement of pleading and proving reliance to establish civil liability.

Causation

The causal relationship between the failure to disclose information and the loss sustained by a plaintiff can be determined on a class-wide basis to the extent that such causal relationship is shown as the link between the wrongful act of the defendant (misinformation) and the loss, which together make up the three key elements of tort liability. In a securities claim, the decrease in the price of a defendant's shares market value

could be a predictable and probable consequence of one's failure to disclose material facts and of reporting misleading information, which establishes a causal relationship between such damage and the tort which caused it.

Damages

The substantial innovation brought about by the Securities Class Action Law is that monetary damages should revert to investors instead of a government fund, as occurs in other substantive areas such as environmental and antitrust law.

Accordingly, individual investors have two years from the date of publication of a notice concerning the payment of damages to present their claims to the relevant court to receive a share of the damages in court liquidation proceedings.

Liquidation may be conducted either collectively by the plaintiffs' association or by separate proceedings filed by investors.

Court involvement and procedure

26 | What is the involvement of the court in collective proceedings and what procedures must be followed to achieve collective treatment of claims? What is the procedure for settling collective proceedings and what is the extent of the court's involvement in settlement?

There is no class certification process under the Brazilian legal system. To achieve collective treatment, securities class actions must be brought by adequate representatives, which are typically either the PPO or an investor association.

During the procedure, the parties are offered some opportunities for compromising and settling the case, which does not attempt a settlement approach by any of the parties at any time. Class action settlements do not require judicial authorisation, but in certain cases may require approval from the PPO.

Opt-in/opt-out

27 | In collective proceedings, are claims opt-in or opt-out?

Investors can opt out from a securities class action to bring individual claims.

Conversely, parties that file individual actions before the class action have the option to request that their actions be stayed until a final decision concerning the collective action is issued, which will be binding with regard to their claims only if it is decided in favour of the plaintiffs. Otherwise, the individual processes can be resumed.

Where the court's judgment in class action proceedings is in favour of the plaintiffs, this ruling produces erga omnes effects. As a consequence, injured parties may enforce this decision in liquidation proceedings.

Regulator and third-party involvement

28 | What role do regulators, professional bodies and other third parties play in collective proceedings?

In securities class actions, the PPO is notified to intervene and join proceedings filed by associations. In addition, the Brazilian Securities and Exchange Commission will also be notified to intervene.

FUNDING AND COSTS

Claim funding

29 | What options are available for plaintiffs to obtain funding for their claims? What are the pros and cons of each option, including any ethical issues relating to litigation funding?

Third parties may fund private litigation in Brazil. Creditors are entitled to assign to a third party their right to claim compensation, provided that the nature of the obligation, the law or an agreement with the debtor do not preclude the assignment. A contingency fee agreement is also available and, according to the Brazilian Bar Association, must be reasonable and not abusive. However, both third-party funding and a fully based contingency fee agreement for securities litigation claims in Brazil are still incipient.

Costs

30 | Who is liable to pay costs in securities litigation? How are they calculated? Are there other procedural issues relevant to costs?

Arbitration

Usually, arbitration costs are fixed by the arbitrators due to the amount of pleadings involved, and are borne by each party equally during the proceedings.

In the arbitration terms of reference, the parties will agree on whether the losing party will pay the winning party's attorney fees or if each party will only bear its own attorney fees. If the parties do not reach an agreement, the arbitrators will resolve the matter. In relation to attorneys' fees, the relevant amount is usually fixed by the arbitrators. If the arbitrators analogically adopt the provisions of the Civil Procedure Code, which is rare, the attorney fees of the winning party will be fixed, based on the amount involved in the dispute.

Securities class action

In securities class actions, associations are exempt from paying court fees and the other parties' expenses or attorney fees, except if a judge rules that the plaintiff association is acting in bad faith.

Privilege

31 | What types of legal privilege exist between litigation funders and litigants?

Brazil does not have any statutes or regulations dealing specifically with third-party funding, and there is a little case law on its use in Brazilian litigation practice. In Brazil, third-party funding is mostly used to fund arbitration disputes, that are essentially confidential among the parties. Thus, the applicable third-party funding legal regime will be practically based on the guidelines issued by the arbitral institution and the arbitration terms of reference agreed by the parties. Therefore, in view of the duty of confidentiality imposed on the parties involved in the litigation, as well the still incipient legal framework related therein, it is advisable that the parties enter into a non-disclosure agreement before disclosing any information to a potential funder.

INVESTMENT FUNDS AND STRUCTURED FINANCE

Interests in investment funds

32 Are there special issues in your jurisdiction with respect to interests in investment funds? What claims are available to investors in a fund against the fund and its directors, and against an investment manager or adviser?

Investment funds in Brazil are organised as a condominium (pool of financial assets jointly owned by the fund's quotaholders), which can be divided into:

1 closed-ended funds, where the redemption of quotas is not permitted until the end of the fund's term of duration, but the quotas may be transferred or assigned by means of one-to-one transference or through a stock exchange; and
2 open-ended funds, where the quotaholders can redeem their quotas at any time but are prohibited, as a general rule, to transfer or assign quotas.

Broadly speaking, both the fiduciary administrator and the asset manager of investment funds have fiduciary duties towards the fund and its quotaholders, and shall be liable for any damages caused to the quotaholders in case of non-compliance with the fund's by-laws or the applicable laws and regulations, including violation of the duty of disclosure. Accordingly, the Brazilian Securities and Exchange Commission is also entitled to apply penalties for any violation of the fund's by-laws or the applicable laws and regulations, including fines, suspension of authorisation or registration for the exercise of the administration or management activities, or temporary disqualification to carry out such activities.

Structured finance vehicles

33 Are there special issues in your country in the structured finance context?

The most common finance vehicles in Brazil are receivables investment funds (FIDCs), real estate investment funds (FIIs) and private equity funds (FIPs). FIDCs may invest in receivables such as credit rights and underlying instruments originating from transactions in the financial, commercial, industrial, real estate, mortgage, leasing and service segments. FIIs invest in real estate developments. FIPs are allowed to invest in shares, debentures, warrants and convertible debt securities issued by listed and unlisted companies. Depending on the fund's qualification, its quotas shall be traded on the stock exchange or organised over-the-counter market, to qualified or non-qualified investors.

Generally speaking, structured finance vehicles, trustees or financial guarantee insurers may too incur, in general, liability in the case of non-compliance with the fund's by-laws, or the applicable laws and regulations, including violation of the duty of disclosure.

CROSS-BORDER ISSUES

Foreign claimants and securities

34 What are the requirements for foreign residents or for holders of securities purchased in other jurisdictions to bring a successful claim in your jurisdiction?

Foreign residents or holders of securities purchased in other jurisdictions are entitled to bring a claim before the Brazilian courts or initiate arbitration proceedings provided that the defendant is domiciled in Brazil, the obligation must be fulfilled in Brazil, the claim is based over a fact occurred or an act practiced in Brazil, or if the parties, tacit or expressly, recognise the Brazilian court's jurisdiction.

A natural defendant is considered domiciled in Brazil if a permanent resident or a Brazilian professional domiciled. A corporation is deemed domiciled in Brazil if headquartered in the country or by having a local subsidiary, agency or affiliated company.

Foreign defendants and issuers

35 What are the requirements for investors to bring a successful claim in your jurisdiction against foreign defendants or issuers of securities traded on a foreign exchange?

Investors are entitled to bring a claim before the Brazilian courts against a foreign defendant or issuer of securities traded on a foreign exchange if: the defendant has a local subsidiary, agency or affiliated company; the obligation must be fulfilled in Brazil; the claim is based on a fact that something occurred or an act was practised in Brazil; or if the parties, tacitly or expressly, recognise the Brazilian court's jurisdiction.

Multiple cross-border claims

36 How do courts in your jurisdiction deal with multiple securities claims in different jurisdictions?

A claim filed before a foreign jurisdiction does not prevent the parties to bring the same or connected claims before the Brazilian courts, provided that there are no international treaties or agreements among the jurisdictions in question restraining such right. In addition, the existence of a claim before the Brazilian jurisdiction does not restrict the parties to enforce a foreign court judgment locally.

Enforcement of foreign judgments

37 What are the requirements in your jurisdiction to enforce foreign court judgments relating to securities transactions?

To enforce foreign court judgments in Brazil, the Superior Court of Justice shall ratify the ruling by means of the analysis of:

- the fulfilment of enforceability formalities required by the law of the jurisdiction where judgment was issued;
- its issuance by a competent court;
- proper service of process on the parties;
- if it is the case, the proper evidence that the defendants' absence has been duly and legally verified; and
- that the judgment shall not be subject to further appeal.

Once the Superior Court of Justice verifies such requirements, it shall ratify the foreign judgement and issue the exequatur.

ALTERNATIVE DISPUTE RESOLUTION

Options, advantages and disadvantages

38 What alternatives to litigation are available in your jurisdiction to redress losses on securities transactions? What are the advantages and disadvantages of arbitration as compared with litigation in your jurisdiction in securities disputes?

Arbitration is a common alternative to litigation to settle individual or group securities claims.

Pros and cons of a securities class action versus individual arbitration

In summary, the advantages of arbitration are:

- the procedure is more expeditious;
- arbitrators are more familiar with business and the law on corporations and capital markets;

- arbitrators are more open and flexible to adopt an evolving interpretation of the law;
- the use of foreign precedents; and
- the higher chances of obtaining a liquid decision, thus, easing the enforceability of the arbitral award.

The disadvantages of arbitration are:
- the higher costs involved;
- the lack of appeals procedure;
- the winning party is entitled to claim its attorney's fees from the losing party, if the parties agree on them; and
- proceedings are protected by confidentiality – meaning there is no public impact, if that is the desired effect.

With regard to securities class actions, the advantages are:
- the lower costs involved; and
- the ruling benefits all investors.

The disadvantages of securities class actions are:
- the participation of the public prosecutor's office and other public entities such as the Brazilian Securities and Exchange Commission;
- the requirement for an adequate representative association to file the class action;
- the procedure is time consuming and lengthy; and
- if there is an arbitration clause in the company's by-laws, the possibility of the court considering that it lacks jurisdiction over the case.

UPDATE AND TRENDS

Key developments of the past year

39 What are the most significant recent legal developments in securities litigation in your jurisdiction? What are the current issues of note and trends relating to securities litigation in your jurisdiction? What issues do you foresee arising in the next few years?

Securities litigation claims based on misinformation are recent and still incipient in Brazil. However, in recent years, there has been active involvement by the Brazilian legal community on this subject and a number of securities litigation cases were filed before the Market Arbitration Chamber.

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GENERAL FRAMEWORK

General climate

1 | Describe the nature and extent of securities litigation in your jurisdiction.

Under Chinese law, the issuance, trading, regulation and legal liability in relation to securities are governed by the Securities Law, which underwent a major amendment on 28 December 2019 and became effective on 1 March 2020. Violation of the Securities Law may give rise to civil, administrative or criminal liability (or a combination of the three), therefore the types of securities litigation include civil, administrative and criminal proceedings. This chapter will focus on civil proceedings in relation to securities litigation.

The amendment to the Securities Law introduced a new representative action mechanism and new provisions regarding investor protection and civil litigation. Furthermore, the Supreme People's Court (SPC) promulgated a new judicial interpretation regarding the new representative action mechanism in July 2020.

In the past, the majority of securities-related disputes were administrative enforcement proceedings initiated by the China Securities Regulatory Commission (CSRC). Civil litigation brought by investors has been heavily restricted by the Certain Provisions on Trial of Civil Compensation Cases Arising from False Statement in Securities Market promulgated by the SPC (the SPC Provisions).

Currently, the law and the relevant judicial interpretation provides that for representative actions in private securities litigation arising from false statements, as a precondition for filing a lawsuit the investor must provide the following:

- evidence of the defendant being subject to:
  - an administrative penalty decision made by the regulatory authority;
  - a criminal verdict; or
  - a disciplinary measure imposed by the securities exchange; or
- the defendant's voluntary confession.

China's courts have also dismissed claims filed in non-representative litigation actions on the basis that none of these pre-filing conditions was satisfied.

There have been several cases involving a representative action mechanism since the legislative and judicial developments in 2020, which attracted much attention. Notably, the pre-filing conditions were exempted in certain cases arising out of false statement in bond issuance. Representative action cases will become increasingly active in the future.

Courts and time frames

2 | What experience do the courts in your jurisdiction have with securities litigation? Are there specialist courts for securities disputes? What is the typical time frame for securities litigation in your jurisdiction?

The number of securities litigation cases accepted and concluded by the Chinese courts has been rapidly growing in recent years. From publicly available information, the Chinese courts have tried and concluded around 40,000 cases from 2014 to 2020, and the number of cases accepted by courts is increasing each year. As such, the Chinese courts are becoming more experienced in securities litigation cases.

In Shanghai, the Shanghai Financial Court was established in 2018 as a specialist court for financial disputes, including securities litigation. Beijing also established a Financial Court in 2021, and the first case heard there was a securities litigation one related to false statement. Courts in other regions of China have set up specialist panels internally for the trial of securities disputes.

The time frame for securities litigation varies greatly from case to case, depending on the complexity of the case, the procedure adopted and the way in which the case is handled by the individual court, etc. As a rough estimate for a typical first instance proceeding, a case may take one to two years from filing to its conclusion.

Government regulation and enforcement

3 | What is the relationship between private securities litigation and government regulation and enforcement in your jurisdiction?

Violation of the Securities Law may give rise to civil, administrative or criminal liability (or a combination of the three). Government regulations deal with administrative liability (eg, fines and bans on market entry), whereas private litigation deals with civil liability (eg, monetary compensation for investors).

In practice, government regulation by the CSRC is far more common than private litigation. This is reflected in the pre-filing conditions established for false statement cases. Further, the Chinese courts heavily rely on the fact-findings made in the course of administrative penalty decisions issued by the CSRC, though this may change in the future as the pre-filing conditions are being relaxed.

CLAIMS AND DEFENCES

Available claims

4 | What types of securities claim are available to investors?

The claims available to investors with respect to losses arising out of securities transactions are mainly statutory claims based on the Securities Law, including:

- claims arising out of false or misleading statements or material omissions of facts in disclosure materials (false statement);
- claims arising out of insider trading; and
- claims arising out of market manipulation.

In practice, civil litigation cases relating to insider trading and market manipulation are rarely seen, and most of the cases relate to claims regarding false statements.

Shares and publicly traded bonds are instruments that commonly give rise to private claims. False statements or material omissions in prospectuses and annual reports, and failure to disclose connected transactions, material guarantees or litigation are typical disputes that give rise to litigation.

Apart from statutory claims based on the Securities Law, investors may also bring general tort or contractual claims for other fraudulent conduct in the course of securities transactions.

Offerings versus secondary-market purchases

5 | How do claims (or defences to claims) arising out of securities offerings differ from those based on secondary-market purchases of securities?

Generally, claims (or defences to claims) relating to false statements may arise out of both securities offerings and secondary-market purchases, whereas claims relating to insider trading and market manipulation mainly arise out of secondary-market purchases. As such, this response will focus on false statement claims.

In terms of legal liability and constituent elements, the Securities Law makes no distinction between claims arising out of securities offerings and those based on secondary-market purchases. Further, article 2 of the Certain Provisions on Trial of Civil Compensation Cases Arising from False Statement in Securities Market promulgated by the Supreme People's Court (the SPC Provisions) explicitly provides that investors can bring false statement claims in both the primary and secondary markets. The law and the SPC Provisions also make no distinction between the primary and secondary markets in terms of defences to claims.

In terms of cause of action, claims arising out of primary-market transactions are usually based on contracts with the issuers, while claims arising out of secondary-market transactions are usually statutory claims based on the Securities Law. Generally speaking, the number of cases involving claims arising out of primary-market transactions is relatively low.

Public versus private securities

6 | Are there differences in the claims or defences available for publicly traded securities and for privately issued securities?

In general, the prevailing view is that statutory claims based on the Securities Law are limited to publicly traded securities. Article 2 of the SPC Provisions also defines a 'securities market' as:

- a market of public offerings;
- a securities exchange market; or
- any other securities markets established with state approval.

As such, privately issued securities are not included in the applicable scope of the SPC Provisions, and therefore statutory claims are not available for privately issued securities. That said, investors may still bring general tort or contractual claims in respect of privately issued securities.

Technically, in terms of legal standards, there are no differences in the claims or defences available to very large versus smaller private companies.

Primary elements of claim

7 | What are the elements of the main types of securities claim?

The necessary elements of a claim for false statement are:

- the disclosure contains a false or misleading statement or a material omission of fact;
- intention or negligence (though this is not required in certain circumstances);
- losses suffered by investors; and
- causation.

The necessary elements of a claim for insider trading are:

- persons with knowledge of inside information purchasing or selling securities, disclosing this information, or recommending other parties trade in these securities prior to the publication of the inside information;
- intention;
- losses suffered by investors; and
- causation.

The necessary elements of a claim for market manipulation are:

- manipulation of the market through various means such as collusion or aggregation of funds or securities to influence the trading price or volume of securities;
- intention;
- losses suffered by investors; and
- causation.

Primary defences

8 | What are the most commonly asserted defences? Which are typically successful?

This response will focus on false statement claims as claims relating to insider trading and market manipulation are rarely seen in practice.

The most commonly asserted defences in false statement cases include:

- the statement or omission of fact is not material;
- there is no causal relationship between the false statement and the losses suffered by investors; and
- due diligence defence (for directors, senior management, etc).

In practice, each of the above defences is difficult to establish.

- Generally, lack of knowledge, lack of expertise and reliance on the opinions of auditors and other professional advisers, etc, is not acceptable.
- The courts will deem false statements as material if the misconduct has been subject to administrative penalty by the China Securities Regulatory Commission.
- Causation is presumed by the courts applying the 'fraud on the market' theory. As such, a causation-based defence is difficult to sustain in practice.

With regard to insider trading disputes, the legal defences available to defendants mainly include the following:

- the relevant information does not constitute insider information;
- the defendant did not know that this information was insider information when the transactions were made;
- the defendant did not utilise the insider information to conduct transactions;
- there was no causal relationship between the insider trading and any losses; and
- the plaintiff suffered no losses.

With regard to market manipulation disputes, the legal defences available to defendants mainly include the following:

- the defendant is not a market manipulator;
- the defendant's behaviour is not material and does not constitute manipulation of the security market;
- there was no causal relationship between the manipulation and any losses; and
- the plaintiff suffered no losses.

Materiality

9 What is the standard for determining whether the misstated or omitted information is of sufficient importance to be actionable?

The offering documents or other statements are actionable if the false or misleading statements or omissions of fact are material. The general standard for determining materiality is whether this information would have a significant influence on the investment decisions of a reasonable investor. In practice, the courts will usually take into account a number of factors in applying the materiality test, including whether the statements involve material disclosure events as prescribed by the law and applicable listing rules, and how the misconduct has or would have affected the share price and trading volume.

Scienter

10 What is the standard for determining whether a defendant has a culpable state of mind to support liability? What types of allegation or evidence are typically advanced to support or defeat state-of-mind requirements?

With respect to false statement claims, the standard for determining whether a defendant has a culpable state of mind differs according to the type of defendant:

- for issuers and public companies, the principle of strict liability applies and no proof of intent or negligence is required;
- for the management of the issuers and public companies that are responsible for the misconduct, culpability is presumed unless the defendants can prove otherwise; and
- for underwriters, sponsors and other professional agencies, culpability is presumed unless the defendants can prove otherwise.

To defeat state-of-mind requirements, the directors and senior management of the issuers, underwriters, sponsors and other professional agencies need to provide evidence that they fulfilled their duties of diligence (eg, proof they raised specific objections to the disclosure and proactively reported misconduct to regulators in a timely manner).

With respect to insider trading or market manipulation claims, proof of intent is required to establish the culpability of the defendants. In practice, intent can usually be inferred once it is established that the defendant carried out insider trading or market manipulation.

Reliance

11 Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

Under the Securities Law and the SPC Provisions, reliance is not a separate element but is assimilated in the determination of causation. The SPC Provisions essentially adopt the fraud on the market theory by establishing a presumption of causation (ie, reliance is presumed if the investors purchased the securities during the relevant time period).

Causation

12 Is proof of causation required? How is causation established? How is causation rebutted?

Proof of causation is required in all types of claims.

In cases involving a false statement, there are two causative links that must be established: that the false statement caused the investment of the investors (ie, investors' reliance) and the losses suffered by the investors. Pursuant to the SPC Provisions, causation is presumed if the following requirements are satisfied:

- the false statement directly related to the securities in which the investors invested;
- the investors purchased the securities on or after the date when the false statement was made and before the false statement was rectified; and
- the investors suffered losses resulting from selling or holding the securities on or after the date when the false representation was rectified.

The presumption of causation can be rebutted if the defendants can prove one of the following:

- the investors sold the securities prior to the date when the false representation was rectified;
- the investors purchased the securities after the date when the false representation was rectified;
- the investors purchased the securities with knowledge of the existence of the false statement;
- the losses were caused by other factors, such as inherent risks of the securities market; or
- the investment was made in bad faith (eg, for the purposes of market manipulation).

For cases involving insider trading and market manipulation, there are no specific rules on the determination of causation and there are few precedents in this regard. In certain cases, some courts have established causation by reference to the rules on causation in false statement cases.

Other elements of claim

13 What elements or defences present special issues in the securities litigation context?

In terms of the substantive law, there are no special elements or requirements in the securities litigation context.

Limitation period

14 What is the relevant period of limitation or repose? When does it begin to run? Can it be extended or shortened?

The statute of limitations is three years. The limitation period cannot be extended or shortened with the parties' mutual agreement, but it can be interrupted or suspended under certain circumstances. For example, when the rights-holder formally issues a demand letter to the defendant, the limitation period will be interrupted and start afresh.

The limitation period begins to run from the date when the rights-holder knows or should have known that its rights have been infringed and the identity of the tortfeasor. In false statements cases where the pre-filing conditions must be satisfied, the limitation period commences on the date when the administrative penalty decision is announced or the criminal judgment takes effect as appropriate.

REMEDIES, PLEADING AND EVIDENCE

Remedies

15 What remedies are available? Do any defences present special issues in the context of securities litigation? What is the measure of damages and how are damages proven?

In false statement, insider trading and market manipulation disputes, the plaintiff may demand compensation for its losses from the defendant.

As for the measure of damages and the relevant burden of proof, in false statement disputes, the defendant should compensate the investor's actual losses, including the difference between the selling and purchase prices, as well as commissions and stamp taxes, and the plaintiff (investor) should provide evidence in support of the alleged amount of losses. However, in terms of the specific calculation formula, at present, there is no uniform calculation method among different courts.

With regard to insider trading and market manipulation disputes, in the absence of specific provisions on the burden of proof for the alleged losses in such cases, the general rule of China's Civil Procedure Law applies and the plaintiff shall bear the burden of proof. Nonetheless, there is no statutory law governing the calculation of losses in such disputes. The court will make a discretionary judgment in light of the specific circumstances of the case and by reference to the relevant provisions on false statements.

Pleading requirements

16 What is required to plead the claim adequately and proceed past the initial pleading?

Similar to ordinary civil claims, to properly file securities claims, the form and content requirements stipulated by the Civil Procedure Law must be fulfilled. The basic requirements include, among other things, the factual background of the case, the legal basis on which the claim is founded and the relief sought.

Procedural defence mechanisms

17 What are the procedural mechanisms available to defendants to defeat, dispose of or narrow claims at an early stage of proceedings? What requirements must be satisfied to obtain each form of pretrial resolution?

There is no mechanism under Chinese law for preliminary examination or pre-trial resolution of the plaintiff's claims. However, prior to a merits hearing, the defendant may raise certain procedural defences.

For example, in judicial practice, the defendant will usually raise the defence that the plaintiff does not have legal standing to institute legal proceedings (eg, the plaintiff did not invest in the relevant securities), and thus the lawsuit should be dismissed.

Evidence

18 How is evidence collected and submitted to the court to support securities claims and defences in your jurisdiction? What rules and common practices apply to the introduction of expert evidence and how receptive are courts to such evidence?

The Securities Law does not impose special requirements for the collection and submission of evidence for securities litigation and the general rules of evidence under the Civil Procedure Law shall apply. The parties are entitled to submit evidence in support of their claims or defences within the statutory time limit for the production of evidence. However, there is no mandatory discovery mechanism under Chinese law.

For expert evidence, a party may apply to have no more than two experts testify and cross-examine the expert opinion submitted by the other party. In recent years, the courts' receptiveness to expert evidence has increased in the context of securities litigation, in particular in specialised areas such as accounting, quantum, etc.

LIABILITY

Primary liability

19 Who may be primarily liable for securities law violations in your jurisdiction?

Under the 2020 Securities Law, liability for securities law violations is not limited to those who make or have ultimate authority over misstatements. Multiple types of actors may be liable in false statement cases. Although the principle of liability varies for different types of actors (fault liability versus strict liability), all actors held liable shall bear joint liability with the issuers or listed companies.

In false statement cases, actors that may be jointly liable for securities law violations include:

- issuers or listed companies whose false statements cause losses to the investors (with or without fault);
- underwriters, sponsors, and professional services agencies (with fault, but fault is presumed unless proven otherwise);
- senior executives of issuers or listed companies, underwriters, and sponsors, such as directors, supervisors, managers and other persons who are responsible for information disclosure (with fault, but fault is presumed unless proven otherwise); and
- controlling shareholders and the ultimate actual controller of the issuer (with fault, but fault is presumed unless proven otherwise).

There are no similar specific rules that apply to insider trading and market manipulation cases. In these cases, as a general principle, only the actor who committed insider trading or manipulation will be liable.

Secondary liability

20 Are the principles of secondary, vicarious or 'controlling person' liability recognised in your jurisdiction?

Under the 2020 Securities Law, in a false statement case, the controlling person will be jointly liable for a false statement made by the issuer unless it can prove that it is not at fault. Apart from 'controlling person' liability, there are no specific principles of secondary or vicarious liability.

There are no similar specific rules that apply to insider trading and market manipulation cases.

Claims against directors

21 What are the special issues in your jurisdiction with respect to securities claims against directors?

The special issues mainly concern the assumption of liability and allocation of the burden of proof.

Under the Securities Law, directors bear joint and several liability for any false or misleading statement or major omission in disclosure materials. In false statement cases, a director who is liable for a false statement must assume joint and several liability for compensating the investors (unless evidence can be provided to prove they are not at fault, such as explicit objections expressed by the director).

There are no similar specific rules applying to insider trading and market manipulation cases.

Claims against underwriters

22 What are the special issues in your jurisdiction with respect to securities claims against underwriters?

The special issues mainly relate to the assumption of liability and the allocation of the burden of proof.

Under the Securities Law, underwriters are presumed to bear joint and several liability for the losses suffered by investors, unless they can prove that they were not at fault. The underwriter will bear joint and several liability for any failure to disclose information in accordance with the Securities Law or where there is a false record, misleading statement or major omission in the disclosure materials owing to its fault.

Claims against auditors

23 What are the special issues in your jurisdiction with respect to securities claims against auditors?

The Supreme People's Court has issued a judicial interpretation on the tortious liability of auditors in the audit business. This interpretation provides that auditors will be assumed to be jointly and severally liable for intentionally caused false statements or major omissions, unless evidence of no fault can be provided.

COLLECTIVE PROCEEDINGS

Availability

24 In what circumstances does your jurisdiction allow collective proceedings?

Under the Securities Law, investors may initiate private actions for violation of the securities law in the following ways: individual litigation, ordinary representative action, and special representative action.

To file an ordinary representative action, the following requirements must be satisfied:

- the plaintiffs consist of more than 10 persons and the conditions for representative actions stipulated under the Civil Procedure Law are met (ie, the subject matter of each of the actions is of the same category and the persons comprising one of the parties are numerous);
- the plaintiffs elect between two and five representatives; and
- at least one of the pre-filing conditions is met to preliminarily prove the existence of the misconduct.

To initiate a special representative action, having met the required pre-filing conditions, 50 or more investors may entrust the designated investor protection agency (currently the China Securities Investor Services Center or the China Securities Investor Protection Fund Corporation Limited) to act as their representative to commence a representative action. The investor protection agency will exercise discretion in deciding whether to commence the proceedings.

Reliance, causation and damages

25 Can reliance, causation and damages be determined on a class-wide basis, or must they be assessed individually?

The Securities Law does not provide specific rules for the assessment of reliance, causation or damages in representative action cases.

Court involvement and procedure

26 What is the involvement of the court in collective proceedings and what procedures must be followed to achieve collective treatment of claims? What is the procedure for settling collective proceedings and what is the extent of the court's involvement in settlement?

For an ordinary representative action under the 2020 Securities Law, the courts may issue public notices stating the particulars and claims of the case and inform investors with similar claims to register with the court within a fixed period of time.

In a special representative action, the investor protection agency entrusted may register with the courts all investors entitled to participate as confirmed by securities registration and clearing institutions, unless such investors explicitly elect to withdraw from the representative action.

For representative actions in the securities litigation context, the courts are in principle required to guide and encourage conciliation for the resolution of securities disputes. However, there are no special provisions regarding court involvement in settlement. Generally, the representatives need to obtain the consent of the members they represent before reaching a settlement with the other party.

Opt-in/opt-out

27 In collective proceedings, are claims opt-in or opt-out?

The Securities Law has adopted a partial opt-in/partial opt-out mechanism in representative action cases.

The ordinary representative action uses the opt-in model. Only investors that have registered with the court within a fixed period of time are subject to the courts' judgment and rulings in the representative actions.

The special representative action adopts the opt-out model. The investor protection agency entrusted may register with the court all investors that are entitled to participate as confirmed by the securities registration and clearing institution, unless the investor explicitly elects to withdraw from the litigation.

Regulator and third-party involvement

28 What role do regulators, professional bodies and other third parties play in collective proceedings?

Under the Civil Procedure Law, regulators, professional bodies and other third parties may participate in litigation as third parties, witnesses or authenticators. In particular, the Securities Law establishes that an investor protection agency entrusted by more than 50 investors may act as a representative in a representative action. Moreover, the courts may entrust professional bodies (by application of the parties) to assess the amount of damages for the investors and the securities registration and clearing institutions may also assist with the enforcement of effective judgments and rulings.

FUNDING AND COSTS

Claim funding

29 What options are available for plaintiffs to obtain funding for their claims? What are the pros and cons of each option, including any ethical issues relating to litigation funding?

There are currently no special arrangements for plaintiffs to obtain funding for their claims in securities litigation. The general regulations in relation to legal fees prohibit contingency fee arrangements in cases where one of the parties consists of more than 10 persons.

Costs

30 | Who is liable to pay costs in securities litigation? How are they calculated? Are there other procedural issues relevant to costs?

There are currently no special arrangements for the apportionment of costs in securities litigation. In general, litigation costs will be borne by the losing party. The litigation costs borne by the losing party refer only to those fees paid to the court (such as the case acceptance fees and application fees) and do not include the attorneys' fees, which, in principle, will be borne by the respective parties.

At present, the plaintiff in securities litigation is not required to provide security for the cost of defending claims.

Privilege

31 | What types of legal privilege exist between litigation funders and litigants?

There are currently no special arrangements for plaintiffs to obtain funding for their claims in securities litigation.

INVESTMENT FUNDS AND STRUCTURED FINANCE

Interests in investment funds

32 | Are there special issues in your jurisdiction with respect to interests in investment funds? What claims are available to investors in a fund against the fund and its directors, and against an investment manager or adviser?

In China, investment funds can be divided into public-offering funds (mutual funds) and private-offering funds (private funds). The former may be offered to non-specific targets or, cumulatively, to more than 200 specific targets.

Comparatively, the trading of interests in mutual funds is subject to fewer limits. Mutual funds are further divided into open-ended funds and closed-ended funds and may be quoted on the exchanges or traded through the relevant fund managers depending on their nature. Private funds are generally managed in the form of partnerships, and the trading of interests in the fund is subject to stricter rules set forth in the Partnerships Law and other regulations and directives.

Parties involved in investment fund activities shall perform their obligations pursuant to the relevant contracts, the Securities Law and the Securities Investment Fund Law, etc. For example, investors can claim compensation for losses suffered as a result of the fund managers' and fund intermediaries' failure to properly perform their obligations.

Structured finance vehicles

33 | Are there special issues in your country in the structured finance context?

A typical structured finance vehicle in China is asset-backed securitisation. Depending on the market where the securities are issued and traded, asset-backed securitisation may be divided into:

- asset-backed securities, which are backed by income-producing assets and traded on the securities exchanges or the institutional market;
- collateralised loan obligations, which are backed by credit assets and are traded on the interbank market; and
- asset-backed notes, which are backed by income-producing assets and are traded on the interbank market.

Generally, asset-backed securitisations in China do not use special purpose vehicle structures. Instead, trust structures are used. The rights and obligations of parties involved in investment activities conducted through structured finance vehicles and the legal relationships formed should be determined on a case-by-case basis with reference to the terms and conditions set forth in the relevant contracts. Having a financial guarantee insurer is optional and if it does exist, the insurer may bring a claim in accordance with the relevant contracts as well.

CROSS-BORDER ISSUES

Foreign claimants and securities

34 | What are the requirements for foreign residents or for holders of securities purchased in other jurisdictions to bring a successful claim in your jurisdiction?

The available methods for foreign residents to purchase securities issued by Chinese issuers include the following:

- qualified foreign institutional investors (QFIIs) and renminbi qualified foreign institutional investors (RQFIIs);
- the Stock Connect between the Hong Kong, Shanghai and Shenzhen stock exchanges; and
- the Shanghai-London Stock Connect.

The rights of foreign investors to bring a claim before the Chinese courts differ under each of the above mechanisms.

- QFII and RQFII: while there are no precedents, theoretically QFIIs and RQFIIs have a direct interest if the securities purchased are held directly in their name, and, therefore, they would have the standing to bring a claim before the Chinese courts.
- Hong Kong-Shanghai and Hong Kong-Shenzhen Stock Connect: securities purchased on the Stock Connect are held by the Hong Kong clearing facilities on behalf of the investors. The China Securities Regulatory Commission has made it clear that the Hong Kong clearing facilities may bring lawsuits on behalf of investors. Further, if the investor can prove that they are the beneficial owners and thus have a direct interest in the case, they may bring a claim themselves before a Chinese court.
- Depository receipts traded on the Shanghai-London Stock Connect: given that the underlying securities are not directly held by the investors, it is unclear under the current rules whether the investors have the standing to bring a claim before the Chinese courts.

Foreign defendants and issuers

35 | What are the requirements for investors to bring a successful claim in your jurisdiction against foreign defendants or issuers of securities traded on a foreign exchange?

If Chinese investors directly purchase securities issued by foreign issuers traded on a foreign exchange, although technically the investors may argue that the Chinese courts should have jurisdiction as courts of the place where the tortious consequences (ie, losses) occurred, it is likely that, in practice, the Chinese courts would be reluctant to accept the case on the basis that it lacks sufficient connection with China. However, the amendment to the Securities Law introduced a new provision regarding extraterritorial application, and it remains to be seen whether and to what extent this provision might change legal practice.

For Chinese investors who invest in the underlying securities of foreign issuers by purchasing depository receipts, the relevant regulations in China have provided them with strong protection. As a mandatory requirement, any disputes relating to these agreements will be governed by Chinese law and subject to the jurisdiction of the Chinese courts.

Multiple cross-border claims

36 How do courts in your jurisdiction deal with multiple securities claims in different jurisdictions?

For a duplicative or parallel dispute, a Chinese court may still accept and hear the case. However, if a foreign court has already rendered a decision over the dispute and the foreign judgment has been recognised by a Chinese court, the Chinese court will not hear the case.

Enforcement of foreign judgments

37 What are the requirements in your jurisdiction to enforce foreign court judgments relating to securities transactions?

A foreign judgement may be recognised and enforced by a Chinese court pursuant to the provisions of an international treaty concluded with that foreign country and China or to which both China and that foreign country are a signatory or in accordance with the principle of reciprocity.

ALTERNATIVE DISPUTE RESOLUTION

Options, advantages and disadvantages

38 What alternatives to litigation are available in your jurisdiction to redress losses on securities transactions? What are the advantages and disadvantages of arbitration as compared with litigation in your jurisdiction in securities disputes?

Arbitration is a well-established alternative dispute resolution (ADR) mechanism in China and the courts are generally supportive of arbitration. However, for claims arising out of false statements, insider trading and market manipulation, it is unlikely that the investors and the counterparties would reach an arbitrated agreement prior to or after a dispute arises.

Mediation is also a frequently used ADR mechanism in China. Mediation may be organised by the court or other entities, such as industry self-disciplinary organisations.

UPDATE AND TRENDS

Key developments of the past year

39 What are the most significant recent legal developments in securities litigation in your jurisdiction? What are the current issues of note and trends relating to securities litigation in your jurisdiction? What issues do you foresee arising in the next few years?

The most significant developments in securities litigation are the cases employing the new representative action mechanisms introduced by the 2020 Securities Law, including both the ordinary representative action and the special representative action mechanisms. These cases have attracted much market attention and many of the issues involved have been widely discussed, such as the liability of intermediary agencies, the procedural mechanism etc.

It is foreseeable that securities litigation in China will become more active in the future, but it remains to be seen how the courts will develop the theory and application of the law in these cases.

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GENERAL FRAMEWORK

General climate

1 | Describe the nature and extent of securities litigation in your jurisdiction.

Securities litigation in Germany has become ubiquitous, particularly since around 17,000 investors filed lawsuits against Deutsche Telekom AG based on allegedly false statements in its prospectus for a public offering in 2000. To help the court cope with the resulting caseload, the legislature enacted Germany's first collective litigation scheme, the Capital Investors Model Proceedings Act (KapMuG), in 2005. Only very recently, and almost 20 years after the filing of the first action, the lead plaintiff attorneys and the defendant worked out a proposal to settle the mass action, and the court currently seized with the matter analysed it, deemed it 'adequate', and strongly recommended all plaintiffs to accept it in order to avoid more years of litigation and uncertainty.

Apart from the *Deutsche Telekom* case, relatively few model proceedings with wide recognition have been initiated, and even fewer have been completed. This is mostly because the drafters of the KapMuG carefully avoided affording model plaintiffs the extra leverage that, for example, US class actions provide. However, the diesel emissions issue recently inspired KapMuG cases against Volkswagen and Porsche with much higher amounts in dispute than the *Deutsche Telekom* case. At the end of 2021, a big new KapMuG request hit the pharmaceutical Bayer AG in connection with allegedly late or misleading market communication in connection with the risks of Bayer's takeover of Glyphosat producer Monsanto. Apart from that, a small number of large individual securities actions brought by litigation special purpose vehicles and individual investors in connection with the attempted takeover of Volkswagen by Porsche SE around 2008 was recast as a KapMuG case with several billion euros in dispute. In addition, innumerable individual actions filed by investors are keeping the courts busy.

The 2012 KapMuG reform somewhat increased the popularity of model proceedings, as the legislature introduced an unbureaucratic method of registering additional claims in these proceedings, suspending the statute of limitations and creating de facto precedents for the benefit of the claimants. While on average there were around 30 applications for model proceedings per year under the old regime, this figure has since risen to more than 50 applications per year.

Recent developments indicate that institutional investors have identified model proceedings as a weapon in their arsenal, potentially combining the KapMuG with other securities litigation trends, such as assigning numerous securities claims to litigation vehicles to benefit from various economies of scale. Institutional investors use these litigation vehicles to pool collective claims of, for example, €1 billion or more in a single action. These vehicles also have the advantage that litigation funders may cover de facto contingency fees or purchase claims at variable prices. In addition, domestic vehicles may be exempt from having to provide security for costs and are more likely to be able to avoid cost reimbursement claims from opposing parties. If the litigation vehicle ultimately loses the action, it may avoid having to compensate the defendant's substantial statutory cost reimbursement claims simply by filing for insolvency.

The German plaintiffs' bar, which has firmly established itself in the wake of the *Deutsche Telekom* model proceedings, has also taken to bringing thousands of parallel cases in almost identical 'copy and paste' complaints. These cases are often directed at the initiators of investment funds, for example.

Moreover, parallel securities claims against initiators of investment funds or issuers are frequently supplemented by mis-selling claims against brokers and dealers, a trend that has been fuelled by a series of Federal Supreme Court judgments holding that a bank's failure to disclose sales commissions received behind customers' backs constitutes mis-selling and gives rise to a damages claim to unwind the tainted transaction. Until 2012, mis-selling claims were excluded from model proceedings, probably also contributing to the KapMuG's initial lack of popularity.

The KapMuG's lifetime was recently extended until 31 December 2023.

In 2018, the German legislature introduced a new model action allowing certain consumer protection bodies to file declaratory actions to have courts determine the liability claims of consumers against commercial parties. This legislation was inspired by the claims of thousands of diesel car owners against the Volkswagen Group in connection with the diesel emissions issue. The new legislation combines elements of the KapMuG with those of the German implementation of the EU Injunctions Directive. The new legislation may also allow the assertion of securities claims, but its main scope of application certainly covers mass claims in connection with the sale of goods and services to consumers. The first model action was filed on 1 November 2018 against Volkswagen and up to 470,000 consumers registered their individual claims with the Federal Justice Office before the first hearing in autumn 2019. In the meantime, the case was settled for over €800 million. Over 60,000 parallel individual actions are due to be settled in the wake of the model action's settlement. Few other model actions have been filed since, mostly dealing with interest calculations in personal savings plans.

In late 2020, the EU enacted a directive on Representative Actions which concern violations of certain EU legislation aimed at the protection of consumers. Its member states are required to implement the directive by the end of 2022. The directive may, among other things, allow authorised consumer protection bodies to prosecute violations of the prospectus directive.

Courts and time frames

2 | What experience do the courts in your jurisdiction have with securities litigation? Are there specialist courts for securities disputes? What is the typical time frame for securities litigation in your jurisdiction?

Over the past 25 years, German courts have built a large amount of experience with securities or investors' claims. Large scale securities litigation, however, remains a relatively rare phenomenon. The vast majority of investment claims concerns closed-end funds (real estate, media funds, and shipping), where no securities are involved. Listed securities, due to the relatively small number of public offerings in Germany, are seldomly the subject matter of securities litigation in its proper meaning.

Most metropolitan District Courts assign securities and investment claims to certain chambers specialising in banking and investment law. KapMuG actions are exclusively entertained by the Higher Regional Courts at the seat of the issuer.

The time frame for a securities litigation greatly varies as a result of the type of proceeding chosen, as well as the number of plaintiffs involved. Individual securities actions may be decided by the District Courts within 12 to 18 months, while KapMuG proceedings can extend over a long time. The initial *Telekom* case started with thousands of individual actions in 2001. It was transformed into a KapMuG proceeding in 2005–2006. The case still is not finally resolved.

Government regulation and enforcement

3 | What is the relationship between private securities litigation and government regulation and enforcement in your jurisdiction?

In principle, private securities litigation and government regulation and enforcement are independent of each other. However, in the absence of pretrial discovery, private claimants systematically attempt to obtain access to investigation files of the prosecutors or supervisory authorities to expand their fact-finding. Public authorities typically do not take any role in private securities actions.

CLAIMS AND DEFENCES

Available claims

4 | What types of securities claim are available to investors?

Three basic types of securities claims are available in Germany:

- specific statutory securities claims, for example, for false or misleading material statements in securities prospectuses (statutory prospectus liability), under the German Securities Prospectus Act, the Capital Investment Code and the Capital Investment Act, or for an issuer's failure to disclose inside information to market participants in a timely and accurate manner (ad hoc liability) under the Securities Trading Act;
- specific customary law securities claims similar to statutory claims, for example, for false or misleading statements in securities prospectuses or other sales materials (civil prospectus liability); and
- general civil claims, such as tort or contractual liability, applied to securities transactions, for example, implied contractual liability for mis-selling by brokers and dealers or counterparties in private securities offerings.

Offerings versus secondary-market purchases

5 | How do claims (or defences to claims) arising out of securities offerings differ from those based on secondary-market purchases of securities?

In some respects, claims arising out of securities offerings do not differ at all from those based on secondary-market purchases of securities because, for example, the liability for securities offerings on securities exchanges extends to all secondary-market transactions of indistinguishable securities for six months after the securities offering. Moreover, the liability for damages arising out of secondary-market transactions in listed securities is, in practice, dominated by ad hoc liability under the Securities Trading Act. Secondary-market transactions in unlisted securities, however, are less well protected because securities claims under general tort law often require intent.

Public versus private securities

6 | Are there differences in the claims or defences available for publicly traded securities and for privately issued securities?

Yes. Many statutory securities claims are aimed at protecting investors against incorrect public statements and are therefore not applicable to privately issued securities. However, courts have, to some extent, levelled the playing field by assuming contractual causes of action in relation to individual securities transactions that achieve substantially similar results to private securities offerings. By contrast, secondary-market transactions outside regulated markets are only subject to general tort liability, which often requires intent on the part of the tortfeasor.

Primary elements of claim

7 | What are the elements of the main types of securities claim?

Statutory prospectus liability generally requires:

- a prospectus (or in some cases only a summary thereof) containing incorrect or incomplete information that is material for the assessment of the securities;
- a purchase of the securities in reliance on the prospectus;
- intent or gross negligence of the person responsible for the prospectus;
- causation; and
- damage:
  - if the securities are listed on a stock exchange:
    - a negative impact of the misrepresented facts on the stock prices; and
    - the stocks must have been purchased within six months of a public offering of indistinguishable securities; and
  - if the securities are not investment funds under the Capital Investment Code or certain other securities:
    - a negative impact of the misrepresented facts on the purchase price of the securities; and
    - the securities must have been purchased during and within two years of the beginning of the offering period.

Civil prospectus liability is largely similar to statutory prospectus liability. However, it not only applies to statutory or substantially similar prospectuses, but also to any written marketing materials for securities.

Ad hoc liability requires:

- an issuer's failure to disclose inside information directly related to the issuer in a timely manner, and:
  - a purchase of the securities after the issuer's failure to disclose the inside information and ongoing ownership of the securities when the inside information becomes public; or

    - a purchase of the securities before the inside information comes into existence and a sale of the securities after the issuer's failure to disclose it;
- an issuer's disclosure of untrue inside information directly related to the issuer, and:
    - reliance on the untrue inside information; or
    - a purchase of the securities after the disclosure of untrue inside information, and:
        - ongoing ownership of the securities when the inaccuracy of the disclosed inside information becomes public; or
        - a sale of the securities before the inaccuracy of the disclosed information becomes public;
- intent or gross negligence of the issuer;
- causation; and
- damage.

Adviser liability requires:
- the implied (or, less common, express) conclusion of an advisory agreement;
- its breach through a failure to advise about:
    - all relevant aspects of the potential investment; and
    - the investment's suitability for the prospective investor;
- causation;
- damage; and
- at the least, negligence of the adviser.

Primary defences

8 | What are the most commonly asserted defences? Which are typically successful?

Defendants will typically argue a lack of (gross) negligence or lack of intent due to lack of knowledge or lack of deemed knowledge of the critical facts, as well as a lack of causation and, finally, contest the damage calculation method. Fact patterns underlying large securities cases usually are neither black nor white. Price relevant information often only emerges as a result of a sequence of incremental events, or from a combination of pieces of information residing in different parts of a complex organisational structure, that may not be obviously material when considered individually.

Materiality

9 | What is the standard for determining whether the misstated or omitted information is of sufficient importance to be actionable?

A prospectus is incorrect if it contains misstatements about material facts, and it is incomplete if facts were omitted that would have been material to the investor's assessment of the securities at the time of publication. The incorrect or omitted information must be material for the assessment of the value of the securities. The prospectus must generally be comprehensible from the perspective of an average reasonable investor who is able to understand the information contained in the prospectus if he or she has carefully read the prospectus and is able to comprehend financial statements, but who has no further special knowledge or education. Higher documentation standards apply if the securities are specifically marketed to a particular group of less sophisticated investors.

Scienter

10 | What is the standard for determining whether a defendant has a culpable state of mind to support liability? What types of allegation or evidence are typically advanced to support or defeat state-of-mind requirements?

Statutory prospectus and ad hoc liability require intent or gross negligence (ie, a violation of obvious standards of care), whereas adviser liability only requires negligence (ie, a violation of ordinary standards of care).

Reliance

11 | Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

For statutory prospectus liability, reliance on the prospectus is presumed by operation of law. The presumption is rebuttable, however, if it can be proved that, on the purchase date, the prospectus no longer influenced buying decisions (eg, owing to the later publication of negative financial statements or a significant drop in the securities' price).

With respect to ad hoc liability, a presumption of reliance is disputed. While some commentators argue that there should be a presumption of reliance comparable to the fraud on the market theory under US law, the German Federal Supreme Court has repeatedly rejected this argument.

Causation

12 | Is proof of causation required? How is causation established? How is causation rebutted?

German law generally requires the breach of duty to have been a proximate cause for the damages claimed by the plaintiff.

Other elements of claim

13 | What elements or defences present special issues in the securities litigation context?

Where no presumption of reliance exists, such as for ad hoc and adviser liability, issues of causation arise. Moreover, the amount of damage caused by inaccurate information is often difficult to establish, but may be estimated by the courts.

Limitation period

14 | What is the relevant period of limitation or repose? When does it begin to run? Can it be extended or shortened?

The general limitation period runs for three years starting at the end of the year in which both the claim has arisen and the claimant has, or, but for gross negligence, should have gained, knowledge of the facts underlying his or her claim, including the identity of the defendant.

REMEDIES, PLEADING AND EVIDENCE

Remedies

15 | What remedies are available? Do any defences present special issues in the context of securities litigation? What is the measure of damages and how are damages proven?

In securities litigation, the main remedy is the payment of damages. Other relevant remedies are rescission of the investment contract and restitution of unjust enrichment.

Prospectus liability

The claimant who still owns the securities can demand the reimbursement of the purchase price (including incidental expenses) in return for

the securities. The reimbursement is limited to the issue price of the securities. If the claimant is no longer in possession of the securities, his or her damages are calculated based on the difference between the purchase price and the sale price.

Ad hoc liability

The Federal Supreme Court recently held that investors can claim not only damages but also rescission. However, the Court limited this remedy to cases of reliance. Thus, ordinarily, damages will be awarded and calculated based on the difference between the purchase price paid and the hypothetical purchase price had the issuer complied with its disclosure obligations.

Pleading requirements

16 | What is required to plead the claim adequately and proceed past the initial pleading?

German civil procedure does not provide for notice pleading but generally requires substantiated pleading of all elements of a claim. The burden of pleading is, however, often reversed for information originating from the opposing party's sphere, such as internal information. Regarding this information, the claimant's burden of pleading is eased and the defendant cannot simply dispute the allegations but needs to submit a substantiated account of the facts. Failure to do so will be treated as an admission of the facts submitted by the opposing party. The extent of the shifting of the burden of pleading depends largely on the circumstances and the discretion of the court. Depending on the circumstances, the reversal of the burden of pleading can have similar effects on the defendant to discovery and disclosure in common law, but without the associated level of expenses.

Procedural defence mechanisms

17 | What are the procedural mechanisms available to defendants to defeat, dispose of or narrow claims at an early stage of proceedings? What requirements must be satisfied to obtain each form of pretrial resolution?

There is no formal mechanism in the Code of Civil Procedure to dispose of claims at an early stage of the proceedings. Courts can, however, dismiss cases for failure to state a claim before hearings progress to the evidentiary phase.

Evidence

18 | How is evidence collected and submitted to the court to support securities claims and defences in your jurisdiction? What rules and common practices apply to the introduction of expert evidence and how receptive are courts to such evidence?

Plaintiffs have the primary burden to establish all relevant facts constituting a breach of law, and the causation of a damage as well as the quantum. Defendants have the burden of proof to show that they did not act (grossly) negligently or intentionally. While there is no pretrial discovery under German law, courts have developed a secondary burden of pleading which forces defendants to effectively disclose a great deal of internal information otherwise inaccessible for plaintiffs. Attempts at cutting corners on such secondary burden may typically expose defendants to the risk that courts might draw adverse inferences against them. Moreover, plaintiffs will try to obtain access to public prosecutors' and regulatory authorities' files if available.

Parties may introduce reports prepared by parties' experts. However, where relevant, the court will appoint its own experts to assess critical facts. However, courts will not investigate facts on their own. Court-appointed experts will be limited to verify facts pleaded by the parties only.

LIABILITY

Primary liability

19 | Who may be primarily liable for securities law violations in your jurisdiction?

The primary liability for breaches of securities laws is on the issuer of the security.

Secondary liability

20 | Are the principles of secondary, vicarious or 'controlling person' liability recognised in your jurisdiction?

'Controlling person' liability exists primarily in the form of prospectus liability. With respect to prospectus liability, not only those who expressly assume responsibility for the prospectus may be liable, but also those who are in fact responsible for it (ie, those who are in factual control of the issuer or the offering and who have an economic interest in the offering).

Claims against directors

21 | What are the special issues in your jurisdiction with respect to securities claims against directors?

The Federal Supreme Court has found directors liable for aiding and abetting members of the management board in respect of the managers' intentional infliction of damage on investors in a manner contrary to public policy, although these are rather extreme and unusual cases. Liability can, for instance, arise from the intentional release of incorrect ad hoc announcements to manipulate the market in a way that will benefit the director. However, the exact criteria for this liability are controversial because, to date, very little case law exists.

Claims against underwriters

22 | What are the special issues in your jurisdiction with respect to securities claims against underwriters?

Underwriter liability is a relatively rare phenomenon in Germany. Only one Federal Supreme Court opinion from 1998 mentions in an obiter dictum the underwriter's liability for the information contained or omitted in the prospectus. However, there are two judgments from the Frankfurt Higher Regional Court from 1994 and 1999 in which the court held underwriters liable for incorrect or incomplete statements in the prospectus.

Owing to this dearth of case law, the standard of care for underwriters is still controversial. It is argued in legal commentaries that, based on their respective level of involvement and access to information, the standard of care required of the lead underwriter should be lower than that of the issuer, whereas the standard of care required of junior banks should be even lower than of the lead underwriter. To date, no court has passed a judgment on the issue.

Claims against auditors

23 | What are the special issues in your jurisdiction with respect to securities claims against auditors?

The liability of auditors in connection with prospectuses is controversial in many respects. While prospectus liability often does not apply, the courts have occasionally resorted to assuming a protective effect of the audit contract for the benefit of a limited class of investors.

However, auditors will generally not be liable to the investing public at large. Exceptions may apply in cases of intentional infliction of damage on investors in a manner that is contrary to public policy. The Wirecard scandal of 2020 has led to a number of actions being filed against that company's long-time auditors.

COLLECTIVE PROCEEDINGS

Availability

24 | In what circumstances does your jurisdiction allow collective proceedings?

The Capital Investors Model Proceedings Act (KapMuG) enables investors to have specific elements of pending securities actions adjudicated collectively. The KapMuG came into force in 2005 and sought to address the German courts' difficulties with processing large numbers of similar securities actions, in particular over 17,000 individual actions brought against Deutsche Telekom. It introduced a unique procedure permitting claimants to collectively litigate common issues of law or fact that arise in their individual securities actions before a single higher court. In 2012, the German legislature amended the KapMuG, simplifying and streamlining model proceedings, and including a new collective-settlement mechanism on an opt-out basis. The amended KapMuG also gives investors the opportunity to benefit indirectly from model proceedings by simply registering their claims with the court in charge of the model proceedings.

Originally, the KapMuG only applied to damages claims directly based on public information concerning securities and claims for specific performance under the German Securities Acquisition and Takeover Act. However, the 2012 amendment extended the scope of the KapMuG to include mis-selling claims in which false or misleading public information concerning securities is an element of a claim against a broker or dealer in financial products. Thus, not only can the parties responsible for prospectuses and ad hoc notices be defendants in model proceedings, but the brokers and dealers.

Reliance, causation and damages

25 | Can reliance, causation and damages be determined on a class-wide basis, or must they be assessed individually?

Reliance and causation can only be determined on a class-wide basis where the applicable statute so provides. Damages must always be assessed individually.

Court involvement and procedure

26 | What is the involvement of the court in collective proceedings and what procedures must be followed to achieve collective treatment of claims? What is the procedure for settling collective proceedings and what is the extent of the court's involvement in settlement?

Courts examine the quorum of motions for model proceedings as well as the commonality of the facts and issues. If the requirements are met, the District Court will submit the common questions of fact and of law to the Higher Regional Court. The Higher Regional Court is bound by the Regional Court's submission. The Higher Regional Court may accept amendments and supplements as requested by the parties of the model proceeding.

The Higher Regional Court may review the appropriateness of a settlement proposal negotiated by the parties. Individual plaintiffs may opt out within one month if up to 30 per cent of the registered plaintiffs reject the settlement. In such cases, they may continue their individual actions.

Opt-in/opt-out

27 | In collective proceedings, are claims opt-in or opt-out?

The KapMuG combines elements of opt-in and opt-out procedures. If a claimant applies for model proceedings, his or her application is published in an internet-based register and the underlying action is automatically stayed. If nine similar applications are filed within six months, the first court to receive an application for model proceedings will submit the common issues of fact or law to the higher regional court for adjudication. At this point, all actions affected by the common issues of fact or law are stayed. The model ruling binds all claimants – including those who have not applied for model proceedings – and does not allow them to continue their individual actions. Affected claimants are only granted the right to withdraw and thereby essentially waive their claims within one month of their actions having been stayed. Once the common issues have been decided, the individual actions are resumed to adjudicate the remaining individual issues of fact or law.

Regulator and third-party involvement

28 | What role do regulators, professional bodies and other third parties play in collective proceedings?

Under the KapMuG, applications for model proceedings can only be brought by investors that are permitted to bring securities actions (ie, individuals and institutional investors, as well as defendants in these actions). The KapMuG does not grant regulators, professional bodies or other third parties the right to participate. These parties play no role in model proceedings.

FUNDING AND COSTS

Claim funding

29 | What options are available for plaintiffs to obtain funding for their claims? What are the pros and cons of each option, including any ethical issues relating to litigation funding?

A common form of funding claim is private litigation insurance. Although for a couple of years insurers tried to exclude prospectus liability claims, the Federal Supreme Court found these clauses to be invalid. Therefore, private litigation insurance will probably be an increasing source of funding in securities litigation in the retail investment area.

Another funding option is contingency fee arrangements, although these are still rare in Germany because they are, as a general rule, contrary to lawyers' standards of professional conduct and, until recently, were categorically prohibited. However, the prohibition was slightly relaxed in 2008 after a ruling of the Federal Constitutional Court, and German law now provides that a contingency fee may be agreed upon in individual cases, but only if the client, because of his or her economic situation, would otherwise, from a reasonable point of view, refrain from pursuing claims. This includes cases of insufficient funds and cases involving high-cost risks that might prove ruinous.

In addition, third-party funding of claims is available and becoming increasingly popular. In Germany, this generally means that a private or commercial third party advances the funds required for court or arbitral proceedings and bears the risk of an adverse cost award in exchange for a share of any judgment or settlement. The *Volkswagen* and *Porsche* securities actions in connection with the diesel emissions issue are largely supported by litigation funders.

Finally, legal aid is available to indigent parties. If granted, legal aid covers the court fees and the applicant's own statutory lawyers' fees but does not cover the costs expended by the opponent, which an unsuccessful applicant must bear in accordance with the Code of Civil Procedure.

Costs

30 Who is liable to pay costs in securities litigation? How are they calculated? Are there other procedural issues relevant to costs?

Under German law, the successful party can recover the costs that were required to bring an appropriate action or to appropriately defend against an action brought by others. These generally include statutory lawyers' fees and incidental expenses, such as court fees. When each of the parties has partially prevailed, the costs are shared proportionally.

Foreign plaintiffs from outside the European Union or European Economic Area and non-signatory states to the Hague Civil Procedure Convention may have to provide security for the cost of defending claims.

Privilege

31 What types of legal privilege exist between litigation funders and litigants?

German civil law does not provide for an equivalent of the common law concept of legal privilege, as there is no pretrial discovery or a general duty of disclosure. Litigants and litigation funders can share information without restrictions. Such information will be protected by the general concept of privacy.

INVESTMENT FUNDS AND STRUCTURED FINANCE

Interests in investment funds

32 Are there special issues in your jurisdiction with respect to interests in investment funds? What claims are available to investors in a fund against the fund and its directors, and against an investment manager or adviser?

For a long time, no statutory prospectus liability existed for the offering of securities in investment funds. This regulatory gap motivated courts to create civil prospectus liability that is similar to the statutory rules. Today, however, a statutory prospectus liability regime for investment funds is provided in the Capital Investment Code. The liability regime is very similar to the previously existing prospectus liability rules for listed stocks. Unlike the issuer of stocks, however, the investment fund itself (as a non-incorporated combination of assets) is usually not liable for incorrect prospectuses.

Structured finance vehicles

33 Are there special issues in your country in the structured finance context?

In 2011, the Federal Supreme Court ruled that banks have particular advisory duties regarding swap transactions. Banks are obligated to ensure that the investor has the same level of information regarding the swap as the bank itself. In particular, the bank must inform the investor if the swap initially has a negative market value from the investor's perspective, because the court sees this advisory duty towards investors as taking precedence over the bank's own interests. The court's opinion is, however, vague and contradictory. It has therefore spawned a lot of follow-on litigation with no end in sight.

In 2015, the Federal Supreme Court issued two further judgments on swap agreements, specifying that the initial negative market value generally only has to be disclosed by the bank that is a party to the swap agreement, not by third-party investment advisers. This is because, in the court's view, the initial negative market value gives rise to a conflict of interest for the swap party that stands to benefit from it, while under a duty to advise the investor objectively. On the other hand, the investment adviser who does not enter into the swap agreement is not subject to this conflict of interests. Therefore, the investment adviser probably only has a duty to disclose the initial negative market value if it is so material that the investor's chance of a return on investment is significantly impaired. Furthermore, the court held that the duty to disclose the initial negative market value does not exist if the customer enters into the swap agreement to reduce risks inherent in a loan agreement subject to a variable interest rate.

CROSS-BORDER ISSUES

Foreign claimants and securities

34 What are the requirements for foreign residents or for holders of securities purchased in other jurisdictions to bring a successful claim in your jurisdiction?

Residents of other jurisdictions are not restricted in bringing actions in Germany, but German statutory prospectus liability does not necessarily apply to securities purchased in other jurisdictions. Outside applicable treaty law, foreign plaintiffs may be required to furnish security to cover statutory cost reimbursement claims of the opponent.

Foreign defendants and issuers

35 What are the requirements for investors to bring a successful claim in your jurisdiction against foreign defendants or issuers of securities traded on a foreign exchange?

For a successful claim against foreign defendants, German courts must first have jurisdiction over the case. Two different jurisdictional regimes exist: European law for foreign defendants from European Union member states and Lugano Convention member states, and domestic law for all others. The jurisdictional regime for non-European defendants is particularly far-reaching. For example, it gives German courts jurisdiction over all defendants who own assets in Germany, with very limited exceptions.

While controversial, under the applicable European conflicts-of-law principles, the fact that securities are traded on a foreign exchange is irrelevant for the issue of which law applies. Therefore, German courts are likely to apply German law if German residents incur damages from transactions abroad. However, German statutory prospectus liability only applies to foreign issuers whose securities are also listed abroad if a jurisdictional link to Germany exists (ie, if the securities were bought in Germany or some of the services in connection with their purchase were rendered in Germany).

Multiple cross-border claims

36 How do courts in your jurisdiction deal with multiple securities claims in different jurisdictions?

German law applies the lis pendens rule and courts will accordingly only assume jurisdiction if the claim is not pending in any other jurisdiction.

Enforcement of foreign judgments

37 What are the requirements in your jurisdiction to enforce foreign court judgments relating to securities transactions?

Foreign judgments will be enforced in Germany if:

- the foreign court had jurisdiction of the case in accordance with German jurisdictional principles;
- the document commencing the proceedings was duly served and made known to the defendant in a timely manner to allow for an adequate defence or, in case of non-compliance with this requirement, the defendant does not invoke this non-compliance or has nevertheless appeared in the proceedings;

- the judgment is not contrary to any prior judgment that became res judicata rendered by a German court or any prior judgment that became res judicata rendered by a foreign court, which is to be recognised in Germany, and the procedure leading to the respective judgment does not contradict any such prior judgment or a proceeding previously commenced and still pending in Germany;
- the effects of its recognition will not be in conflict with fundamental principles of German law, including, without limitation, fundamental rights under the German Constitution;
- the reciprocity of the enforcement of judgments is guaranteed; and
- the judgment has become res judicata under the law of the place where it was pronounced.

Particularly relevant in the securities litigation context is the non-recognition of a judgment if the foreign court did not have jurisdiction according to German law. In connection with the Capital Investors Model Proceedings Act, the German legislature introduced a statutory provision regarding the exclusive jurisdiction of courts at the seat of the issuer for securities actions, which was intended to operate as a blocking statute. Some commentators have, erroneously, construed this provision as barring the enforcement of all foreign securities judgments against German issuers, creating unnecessary legal uncertainty for German companies intending to issue securities abroad.

ALTERNATIVE DISPUTE RESOLUTION

Options, advantages and disadvantages

38 What alternatives to litigation are available in your jurisdiction to redress losses on securities transactions? What are the advantages and disadvantages of arbitration as compared with litigation in your jurisdiction in securities disputes?

In Germany, parties are free to agree on alternative methods of dispute resolution. The most common method of alternative dispute resolution is arbitration.

In 1998, Germany essentially adopted and incorporated the United Nations Commission on International Trade Law's Model Law on International Commercial Arbitration in its entirety, with minor qualifications and clarifications only. The provisions can be found in the German Code of Civil Procedure, Tenth Book. The provisions on arbitration in the Code of Civil Procedure apply only if an arbitration is seated in Germany (with few exemptions), and they apply equally to international and domestic arbitration. Under German law, arbitration agreements must be in writing, but the concept of the written form is open for modern means of communication such as email. German courts have no discretion to stay civil court proceedings, but must reject the action as inadmissible if they find an arbitration agreement to be valid.

Parties seeking enforcement of an arbitral award must obtain exequatur from a German court before the award, whether domestic or foreign, can be enforced. Germany is a party to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

German law distinguishes between court-annexed and private mediation. Because German courts, at all stages of the proceedings, are to act in the interests of arriving at an amicable resolution of the legal dispute or of the individual points at issue, the Code of Civil Procedure requires that any hearing shall be preceded by a conciliation hearing, unless efforts to come to an agreement have already been made before an alternative dispute resolution entity, or the conciliation hearing obviously has no prospects of success. For the conciliation hearing, and for further attempts at resolving the dispute, the court may refer the parties to a judge delegated for this purpose, who is not authorised to make a decision (conciliation judge). Conciliation judges may avail themselves of all methods of conflict resolution, including mediation. Additionally, German courts may suggest at any point in the proceedings that the parties pursue these procedures. Should the parties decide to pursue mediation or other alternative conflict resolution procedures, the court will order the proceedings stayed.

In Germany, there is not simply one office of an ombudsperson. Instead, there are several offices of ombudspersons dealing with complaints against members of specific industries (eg, investment funds, banks, building societies, utility companies, insurance companies and public transport companies) or against individuals (eg, lawyers).

UPDATE AND TRENDS

Key developments of the past year

39 What are the most significant recent legal developments in securities litigation in your jurisdiction? What are the current issues of note and trends relating to securities litigation in your jurisdiction? What issues do you foresee arising in the next few years?

Germany has introduced a new model action, the Model Declaratory Proceeding. Cartel damages lawsuits are another potential field for collective redress mechanisms in the near future. There has been a steep rise in cartel damages follow-on litigation in Germany over the past few years. They could also be enforced by way of a model action. Current cartel damages actions have been asserted by litigation special purpose vehicles that allow the claims of commercial parties to be combined.

In addition, the European Commission pushed another initiative aimed at introducing collective redress mechanisms across EU member states. The new Directive on Representative Actions, which was adopted at the end of 2020, allows for an authorised consumer protection association to be provided with the exclusive right to sue. The consumer association may also assert damages and payment claims, which go beyond the German model action in that it only allows a determination of liability or of facts. EU member states are required to implement the directive within 24 months.

The arrival of US plaintiff firms in Germany, alongside corresponding litigation funders, continues to play an increasingly important role in the future development of securities litigation and other types of collective redress.

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GENERAL FRAMEWORK

General climate

1 | Describe the nature and extent of securities litigation in your jurisdiction.

The Companies Act 2013 (the 2013 Act) provides for a statutory cause of action to any person who has subscribed to securities of a company offered through a prospectus and has suffered losses by relying on any statement in the prospectus that was untrue or misleading or owing to the omission of any matter in the prospectus. However, rarely has any such litigation been initiated in the recent past.

In addition to the above, securities litigation also arises owing to enforcement actions initiated by the Securities and Exchange Board of India (SEBI), the securities market regulator in India. SEBI has the power to conduct investigations and pass orders prohibiting individuals or entities that were involved in matters pertaining to market manipulation and price rigging, issue-related manipulation, insider trading, takeovers and other matters.

Most of the securities litigation in India has dwelt upon the enforceability of the restriction on the transfer of shares of the company until substantial provisions of the 2013 Act were brought into force. Prior to the 2013 Act coming into effect, the Companies Act 1956 (the 1956 Act), which was the governing statute dealing with shares and securities, provided that the shares or debentures and any interest therein of a company shall be freely transferable subject to the provisions of the 1956 Act. Commercially, restrictions on the transfer of shares are common and often form the basis of a joint venture or investment arrangements. The enforceability of restrictions on the transfer of shares of the company was unclear following the rulings of various high courts in India. There was considerable confusion on whether restrictions on the transfer of shares of a public company were enforceable if these were not included in the articles of association of the company. This position was settled by the 2013 Act, which permitted share transfer restrictions between shareholders of the company under a contract.

In addition, the central government passed the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act 2015 pursuant to which commercial courts have been established to expedite the adjudication of matters arising out of various commercial transactions, including joint venture agreements and shareholders' agreements.

There has also been litigation involving oppression and mismanagement. The 2013 Act provides a right to the shareholders of the company to approach the National Company Law Tribunal (NCLT) in cases of oppression and mismanagement. Pursuant to the 2013 Act, shareholders constituting 100 or more members of a company or one-tenth or more of the total number of its members, whichever is less, or any member or members holding one-tenth or more of the issued share capital of the company may approach the NCLT to complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members and to accordingly seek specified relief.

Further, with the notification of the Insolvency and Bankruptcy Code 2016 (IBC), which is meant to introduce a time-bound and systematic mechanism for resolution of insolvencies while ensuring that the interests of all stakeholders are protected, questions have arisen in situations of a conflict between the non-obstante provisions of the IBC and enforcement powers of SEBI, especially during the moratorium period under the IBC.

Courts and time frames

2 | What experience do the courts in your jurisdiction have with securities litigation? Are there specialist courts for securities disputes? What is the typical time frame for securities litigation in your jurisdiction?

Answer coming soon.

Government regulation and enforcement

3 | What is the relationship between private securities litigation and government regulation and enforcement in your jurisdiction?

Answer coming soon.

CLAIMS AND DEFENCES

Available claims

4 | What types of securities claim are available to investors?

Section 35 of the Companies Act 2013 (the 2013 Act) provides for a statutory cause of action to any person who has subscribed for securities of a company offered through a prospectus and has suffered losses by relying on any statement in the prospectus that was untrue or misleading or owing to the omission of any matter in the prospectus. An investor can make a claim for compensation under section 35 of the 2013 Act against the company, its directors, its promoters, the expert referred to in the prospectus and any person who has authorised the issue of the prospectus. This statutory right is in addition and does not diminish or reduce the right of an investor to file a criminal complaint under sections 34, 36 and 447 of the 2013 Act.

The provisions of the 2013 Act do not omit or diminish any liability that a person may incur under general law or under other provisions. The investor is entitled to terminate his or her contract of subscription to the securities of the company and seek repayment and compensation under the provisions of the Indian Contract Act 1872 (the Contract Act) if there is a misrepresentation or an omission in the prospectus.

Shareholders of a company who complain that the affairs of the company are being conducted in a manner prejudicial to the public interest or in a manner oppressive to any member or members can approach the relevant forum for specific relief provided that these members are eligible to file these complaints according to the provisions of the 2013 Act. Further, any number of members or depositors or any class of them can initiate a class action suit if they are of the opinion that the management or affairs of the company are being conducted in a manner prejudicial to the interest of the company, its members or its depositors, and may, inter alia, seek appropriate relief against the company, its directors, its auditors or an expert, adviser or consultant for any fraudulent, unlawful or wrongful act or conduct.

As an additional protective measure for listed companies, the Securities and Exchange Board of India (SEBI) has formulated the SEBI Complaints Redressal System (SCORES), which mandates all listed companies to redress the grievance of the shareholders raised on the SCORES platform and inform them of the steps taken within 30 days of the receipt of the complaints. If the company fails to do so, it is liable under the provisions of the Securities and Exchange Board of India Act 1992.

Offerings versus secondary-market purchases

5 | How do claims (or defences to claims) arising out of securities offerings differ from those based on secondary-market purchases of securities?

In the case of secondary market purchases, the investor would have a remedy under section 36 of the 2013 Act, which is a generic provision covering all instances of misstatements or fraud.

Section 35 of the 2013 Act provides for statutory cause of action for misrepresentation in the prospectus. Under section 36 of the 2013 Act, any person who knowingly makes any statement, promise or forecast that is false or misleading, or who deliberately conceals a material fact to induce an investor to purchase securities, would be guilty and liable for consequence under section 447 of the 2013 Act. Additionally, an investor would have a remedy under the Contract Act for damages for breach of contract.

Investors who have purchased shares from a secondary market can also file a complaint with SEBI against the company on the SCORES platform, and a general complaint can be filed against any wrongdoing in relation to a particular scrip.

Public versus private securities

6 | Are there differences in the claims or defences available for publicly traded securities and for privately issued securities?

The rights of an investor to file a criminal complaint under section 34 and seek compensation under section 35 of the 2013 Act are limited to untrue or misleading statements made in the prospectus and, thus, are not available to investors who have purchased securities that were issued on private placement. However, under sections 36 and 447 of the 2013 Act, these investors have a right to proceed against any person who knowingly makes any statement, promise or forecast that is false or misleading, or that deliberately conceals a material fact inducing an investor to purchase securities. This right under section 36 is in addition to the rights available to the investor in general law.

Additionally, in the case of publicly traded securities, the investors may seek recourse from SEBI for damage suffered by the investor owing to non-compliance by the company with any of the regulations prescribed by SEBI, such as:

- insider trading norms under the SEBI (Prohibition of Insider Trading) Regulations 2015;
- fraudulent and unlawful trade practices under the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003; or
- any non-compliance under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011.

The investor may also seek redress through the SCORES platform.

Primary elements of claim

7 | What are the elements of the main types of securities claim?

The principal elements of a securities claim are the following.

Misrepresentation and omission (section 35 of the 2013 Act)
An investor who subscribed to securities, acting on misleading representation, or omission or incorrect statement and who suffered any loss or damage by relying on this statement, can bring a claim against the company, its directors, its promoters, the expert referred to in the prospectus and any person who has authorised the issue of the prospectus. If it is proved that the prospectus has been issued with the intent to defraud the investors then all such people are personally liable without any limitation of liability for all or any of the losses suffered by the investors.

Fraudulent actions (section 36 of the 2013 Act)
A claim for fraudulent actions can be made if a statement, promise or forecast was made knowingly or recklessly that is false, deceptive or misleading, or that deliberately conceals a material fact that induces the investor to enter into any agreement for acquiring the securities.

Refusal for registration (section 58 of the 2013 Act)
A claim for refusal of registration can be made if a public company refuses to register a transfer without sufficient cause within 30 days of receipt of the instrument of transfer from the transferee.

Oppression and mismanagement (sections 241 of the 2013 Act)
If the affairs of the company are being conducted in a manner prejudicial to the public interest or prejudicial or oppressive to the interest of the members of the company, complaints can be filed by members who are eligible to file these complaints in terms of the provisions of the 2013 Act.

Rescinding a contract (section 19 of the Contract Act)
A claim can be made to rescind a contract if consent for entering into the transaction was obtained by fraud, coercion or misrepresentation; the fraud could not have been discovered with ordinary diligence by the party whose consent was given as a result of this misrepresentation, and the fraud or misrepresentation is directly related to the consent given by this party when entering into the transaction.

Damages (section 73 of the Contract Act)
A claim can be made for damages if any of the terms or conditions of the contract have been breached if the breach has resulted in damage or loss to the investor, and this loss or damage is not a remote or indirect loss.

Primary defences

8 | What are the most commonly asserted defences? Which are typically successful?

Answer coming soon.

Materiality

9 What is the standard for determining whether the misstated or omitted information is of sufficient importance to be actionable?

The plaintiff must demonstrate that there was a misstatement in the prospectus, either through a positively inaccurate statement contained in the prospectus or the omission of a statement of fact that ought to have been contained in the prospectus to give a right of claim under section 35 of the 2013 Act. If any claim is raised on account of fraud, the plaintiff must demonstrate the culpable state of mind of the person against whom the claim is made. If the plaintiff must proceed under section 36 of the 2013 Act then he or she will also have to demonstrate that the defendant had knowingly or recklessly made the statement, promise or forecast that was false, deceptive or misleading, or that deliberately concealed a material fact.

Scienter

10 What is the standard for determining whether a defendant has a culpable state of mind to support liability? What types of allegation or evidence are typically advanced to support or defeat state-of-mind requirements?

The person making the claim under section 35(1) of the 2013 Act is not required to demonstrate that the defendant has a culpable state of mind. However, if the claim is raised on account of fraud under section 35(3) of the 2013 Act, the plaintiff must demonstrate the culpable state of mind of the person against whom the claim is made. While there are no specified thresholds, the courts and tribunals generally look into the facts and circumstances surrounding the claim to ascertain the motivation and intention of the parties and whether there existed a culpable state of mind.

Reliance

11 Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

Section 35 of the 2013 Act does not require the claimant to demonstrate that he or she had placed reliance on the prospectus, any misstatement in the prospectus or omission of any matter in the prospectus. However, the claimant must establish that the loss or damage was caused by the relevant misstatement in the prospectus or any omission of material fact in the prospectus.

In the event that directors, promoters or persons in charge have been convicted for any of their past conduct, it may be presumed they are involved in subsequent violations.

Causation

12 Is proof of causation required? How is causation established? How is causation rebutted?

Section 35 of the 2013 Act provides that the loss should have been caused by the misstatement or the omission of matter in the prospectus. As such, the claimant must establish that the loss or damage was caused by the relevant misstatement or the omission of material fact in the prospectus.

Even under common law, a claimant must demonstrate that the loss or damage suffered was because of the misrepresentation by the defendant.

Other elements of claim

13 What elements or defences present special issues in the securities litigation context?

In terms of a misstatement in or the omission from any matter in the prospectus, the challenge has always been in establishing the alleged non-disclosure or misrepresentation in the prospectus that resulted in losses to the claimant and the quantum of compensation.

Securities litigation also presents a unique situation for companies claimed against because once an investor has made a claim for losses against a company, and when these claims have a material impact on the reputation of the company, the claim further affects the market price of the securities, causing a twofold loss to the company and the investors.

Further, in the case of publicly traded securities, where the interests of the public stakeholders are also involved, the tribunal or the regulator must bear in mind the interests of these stakeholders before passing any orders in favour of the complainant.

Lastly, securities litigation generally proves to be a time-consuming process in India.

Limitation period

14 What is the relevant period of limitation or repose? When does it begin to run? Can it be extended or shortened?

The limitation period for a securities claim on the grounds of fraud, misleading statement or misrepresentation in the prospectus is three years from the date on which the fraud, misleading statement or misrepresentation was discovered. A statutorily prescribed period of limitation cannot be shortened by way of agreement between the parties. However, the period of limitation can be extended by the court or relevant tribunal in cases where sufficient cause for delay in instituting proceedings is satisfactorily explained. There is no limitation period prescribed for regulatory action that may be initiated by SEBI.

REMEDIES, PLEADING AND EVIDENCE

Remedies

15 What remedies are available? Do any defences present special issues in the context of securities litigation? What is the measure of damages and how are damages proven?

Civil law remedies

An investor can make a claim for compensation under section 35 of the Companies Act 2013 (the 2013 Act) against the company, its directors, its promoters, the expert referred to in the prospectus and any person who has authorised the issue of the prospectus. In addition, the investor is entitled to terminate his or her contract of subscription to the securities of the company and seek repayment and compensation under the provisions of the Indian Contract Act 1872 if there is a misrepresentation or an omission in the prospectus.

Shareholders of a company who complain that the affairs of the company are being conducted in a manner prejudicial to the public interest or in a manner oppressive to any member or members can approach the relevant forum for specific relief provided that these members are eligible to file these complaints according to the provisions of the 2013 Act. Further, any number of members or depositors or any class of them can initiate a class action suit.

In addition to this, an investor can also approach the Securities and Exchange Board of India (SEBI) by way of a formal complaint. Under the regulatory framework, SEBI can pass appropriate directions and orders to safeguard the interest of investors in case of public issues that, among other things, restrict an issuing company from newly issuing

securities, direct the merchant banker not to release funds raised from the public issue to the company or call upon the issuing company to repay the proceeds of the issue. Additionally, the investors may seek recourse from SEBI if the damage is suffered by an investor as a result of non-compliance by the company with any of the following regulations, among others:

- SEBI (Prohibition of Insider Trading) Regulations 2015;
- SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003; or
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011.

The investor may also seek redress under the SEBI Complaints Redressal System platform.

The company is liable to be punished with a fine if it has issued a prospectus in contravention of section 26 of the 2013 Act. Further, every person who is knowingly a party to the issue of this prospectus is also liable to be punished with imprisonment of up to three years or a fine, or both.

Criminal law remedies

Section 447 of the 2013 Act provides for criminal liability and specifies the punishment for fraud committed under sections 34 and 36 of the 2013 Act. A person who is found guilty of fraud may be imprisoned for a term of six months, which may extend up to 10 years. In the event that the fraud in question involves public interest, the minimum term of imprisonment is three years. Section 447 of the 2013 Act also provides for a fine equivalent to the amount involved in the fraud, which may be extended to three times the amount involved in the fraud.

Measure of damages

The measure of damages for the loss suffered owing to an untrue statement or any non-disclosure has not been specified under the statute and is always contentious. Measures of damages vary depending upon the nature of the claim for losses and also on the intent of the defendant and the demonstration of knowledge, recklessness or fraud.

Pleading requirements

16 | What is required to plead the claim adequately and proceed past the initial pleading?

To plead a claim, the plaintiff must file a statement of claim by way of a plaint that includes:

- the facts of the case;
- the nature of claim;
- the documents on which the plaintiff relies for the facts and to support his or her claim;
- the jurisdiction of the forum; and
- a statement to the effect that the suit is not barred by limitation and that the requisite court fee has been paid.

Procedural defence mechanisms

17 | What are the procedural mechanisms available to defendants to defeat, dispose of or narrow claims at an early stage of proceedings? What requirements must be satisfied to obtain each form of pretrial resolution?

Under the provisions of the Code of Civil Procedure 1908 (CPC), a suit can be defeated at an early stage on the ground of the lack of jurisdiction of the court, or by a bar on the suit created by any law for the time it was in force. Apart from this, there is no mechanism through which a suit can be defeated at an early stage. A defendant seeking this relief will have to make an application under order 14, rule 2 of the CPC.

A defendant can also narrow down the scope of a suit at an initial stage by admitting a partial claim and filing a written statement to this effect. In this circumstance, the court will pass a preliminary decree to the extent of the amount admitted by the defendant. However, this decree shall in no way affect the maintainability of the suit as regards the remaining claim amount.

Further, the CPC also allows for the settlement of disputes, whereby a settlement agreement is drawn and the court passes a decree in terms of the settlement agreement.

In cases in which a regulatory action has been initiated by SEBI, the defending entity can make an application under provisions of SEBI (Settlement of Administrative and Civil Proceedings) Regulations 2018. Under these regulations, the party seeking a settlement is required to file a settlement proposal along with a non-refundable settlement fee. This application must be made within 60 days of the show-cause notice issued to the entity.

In cases where a claim has been brought before the National Company Law Tribunal (NCLT), the NCLT has the power to determine the procedure to dispose of a claim in accordance with the rules of natural justice.

Evidence

18 | How is evidence collected and submitted to the court to support securities claims and defences in your jurisdiction? What rules and common practices apply to the introduction of expert evidence and how receptive are courts to such evidence?

Answer coming soon.

LIABILITY

Primary liability

19 | Who may be primarily liable for securities law violations in your jurisdiction?

Answer coming soon.

Secondary liability

20 | Are the principles of secondary, vicarious or 'controlling person' liability recognised in your jurisdiction?

Under Indian laws, the principal is liable for any fraud or misrepresentation committed by his or her agent within the scope of the agent's authority. Where a company is a principal it would also be liable for any fraud of its officers. The liability of the company will depend upon the extent to which the fraudulent state of mind of an officer is attributable to the company. These principles are also applicable to the issue of a prospectus containing fraudulent or misleading statements. The company will be liable:

- when the misrepresentations are made by the directors or other general agents of the company entitled to act on behalf of the company and acting as such;
- when the misrepresentations are made by an agent who is specially authorised for the purpose;
- when the directors making the allotment were aware of the fact of misrepresentation and also knew that the applicants for shares were induced by the misrepresentation; and
- when, to the knowledge of the company or its agents, the contract is made on the basis of particular representations that later turn out to be untrue.

Section 35 of the Companies Act 2013 specifically imposes liability on every person who has authorised the issue of the prospectus, which

includes the directors, promoters and experts named as such in the prospectus. Indian law also recognises the principle of vicarious liability of every person who, at the time when the offence was conducted, was in charge of, or was responsible for, the conduct of the business of the company. This principle is also recognised by the Securities and Exchange Board of India and has been upheld by the Supreme Court of India in the matter of *N Narayan v Adjudicating Officer*.

Claims against directors

21 What are the special issues in your jurisdiction with respect to securities claims against directors?

The term 'director' in India includes a person appointed as a director and a person acting in that capacity. Liability of directors with respect to the issuance of securities has been laid out in sections 34 and 35 of the Companies Act 2013. A director may attract both civil and criminal liability for issuing a misleading prospectus. Civil liability is vested in directors irrespective of whether there was an intention to issue a misleading prospectus, but if there was an intention, the liability is greater. Criminal liability is vested in directors only when there is an intention to defraud potential investors, and when there was knowledge of misleading statements or omissions.

However, the liability of independent directors is rather different and contentious, as penal action against independent directors can only be initiated after the registrar of the companies concludes that the director is an officer in default. This protection has been accorded to safeguard the interests of independent directors. Even in cases of regulatory action, the Securities and Exchange Board of India has been cautious in taking action against independent directors in cases of misstatement in a prospectus.

Claims against underwriters

22 What are the special issues in your jurisdiction with respect to securities claims against underwriters?

The underwriters and other intermediaries involved in the listing of securities are governed by the regulations framed by the Securities and Exchange Board of India (SEBI). The merchant bankers are required to conduct comprehensive due diligence for the purpose of meeting with statutory obligations and to reduce the risks involved in a transaction. The liability of the merchant bankers has increased with the increase in statutory compliance and unwritten practices being mandated by SEBI. The merchant bankers cannot limit themselves to conducting due diligence merely to comply with the statutory requirements, but are required to play a more active role with intent to ensure that all the disclosures made in the offer documents are true and fair in every aspect. If the merchant bankers are in default then they can be subjected to a penalty and can also be made liable for suspension or cancellation of their licence. In the past, SEBI has suspended the registration certificates of underwriters in cases where it was found that underwriters had not carried out their duty of conducting a comprehensive due diligence in an adequate manner.

There are no specific provisions in the the Companies Act 2013 (the 2013 Act) dealing with the liability of the underwriters. The scope of section 35 of the 2013 Act is very wide as it makes every person liable who has authorised the contents and the issue of the prospectus.

The underwriters can also attract liability under section 35 of the 2013 Act if they had accepted the responsibility for the contents of the prospectus. In practice, the underwriters do not accept any of the responsibility as regards the contents of the prospectus nor do they authorise the issue of the prospectus. As such, claims under section 35 of the 2013 Act against the underwriters are improbable.

Claims against auditors

23 What are the special issues in your jurisdiction with respect to securities claims against auditors?

In the event of an auditor's non-compliance with the provisions of the 2013 Act, he or she could be punished with a fine of not less than 5,000 rupees, which may extend to 500,000 rupees. However, if these provisions are contravened knowingly or wilfully with an intention to deceive the company or its shareholders, creditors or tax authorities, the auditor would be punishable with imprisonment for a term that may extend to one year and with a fine ranging from 100,000 to 2.5 million rupees.

In the event an auditor is convicted of non-compliance, he or she can be made liable to refund the remuneration received by him or her and can also be required to pay for damage suffered by the company, statutory bodies or authorities or any other persons for loss arising out of incorrect or misleading statements of particulars made in his or her audit report.

In addition, section 35 of the 2013 Act makes every person who has authorised the contents and the issue of the prospectus liable. The auditors would be liable under section 35 of the 2013 Act if they have provided incorrect or misleading statements of particulars in their audit report, which forms part of the prospectus. In terms of section 245 of the 2013 Act, where any class action is initiated against the auditors to seek damages or compensation or to demand any other suitable action from or against the audit firm, then the liability accrues to this audit firm and on each partner of it who was involved in making any improper or misleading statements in their audit report or who acted in a fraudulent, unlawful or wrongful manner. Additionally, the Institute of Chartered Accountants of India may also initiate proceedings against an auditor for making improper or misleading statements of particulars in the audit report.

Additionally, when the financial statements of listed companies are involved, SEBI has regularly exercised its powers to issue directions against auditors for their complicity in or their failure to detect financial statement fraud. The most significant of these directions include restrictions on the impugned auditor from taking up mandates from listed companies for specified time periods.

COLLECTIVE PROCEEDINGS

Availability

24 In what circumstances does your jurisdiction allow collective proceedings?

Section 37 of the Companies Act 2013 (the 2013 Act) provides for the manner in which the affected person may take any action under sections 34, 35 and 36 of the 2013 Act. Section 37 provides that a suit may be filed by any person, group of persons or association of persons affected by the misleading statement or the inclusion or omission of any matter in the prospectus.

Section 245 of the 2013 Act also allows for the initiation of class action suits by a specified number of members or depositors or any class of them, if they are of the opinion that the management or control of the affairs of the company is being conducted in a manner prejudicial to the interests of the company or its members or depositors. In addition, section 245 allows a specified number of members or depositors or any class of them to, among other things, claim damages or compensation, or demand any other suitable action from or against the company or its directors for any fraudulent, unlawful or wrongful act, omission or conduct or any such likely act or conduct on their part. Such a class action can also be initiated against the auditors and any expert, adviser, consultant or any other person for making a misleading statement, or for any fraudulent, unlawful or wrongful acts or conduct.

An application for a class action suit is required to be filed before the National Company Law Tribunal.

Further, a representative suit can also be filed in this regard under order 1, rule 8 of the Code of Civil Procedure 1908. The provisions of this rule apply only if:

- the parties are numerous;
- they have the same interest;
- the necessary permission of the court is obtained or direction is given; and
- notice is given to all the parties that seek to be represented by the representative suit.

Reliance, causation and damages

25 | Can reliance, causation and damages be determined on a class-wide basis, or must they be assessed individually?

Answer coming soon.

Court involvement and procedure

26 | What is the involvement of the court in collective proceedings and what procedures must be followed to achieve collective treatment of claims? What is the procedure for settling collective proceedings and what is the extent of the court's involvement in settlement?

Answer coming soon.

Opt-in/opt-out

27 | In collective proceedings, are claims opt-in or opt-out?

In a class action proceeding, the claims are assessed on a class-wide basis and the outcome of the proceeding is binding on all the members of the class, until and unless a member has decided to opt-out of it by following the procedure as provided under the 2013 Act.

Regulator and third-party involvement

28 | What role do regulators, professional bodies and other third parties play in collective proceedings?

No role has been prescribed or attributed to the regulators, professional bodies and other third parties in representative suits under order 1, rule 8 of the Code of Civil Procedure 1908 or in class action suits under section 245 of the 2013 Act.

FUNDING AND COSTS

Claim funding

29 | What options are available for plaintiffs to obtain funding for their claims? What are the pros and cons of each option, including any ethical issues relating to litigation funding?

Section 125 of the Companies Act 2013 (the 2013 Act) provides for the establishment of a fund named the Investor Education and Protection Fund. The money credited to this fund may be utilised for, among other things, the distribution of disgorged funds to those who have suffered losses owing to the unlawful actions of any person. The Investor Education and Protection Fund can also be utilised to reimburse legal expenses incurred in pursuing collective suits under sections 37 and 245 of the 2013 Act, as may be sanctioned by the court.

The plaintiffs may also approach proxy firms that may assist the investors in funding their claim, along with providing legal and advisory services.

Costs

30 | Who is liable to pay costs in securities litigation? How are they calculated? Are there other procedural issues relevant to costs?

There are no specific provisions related to the levy of costs in securities litigation, and the issue of the levy of costs is governed by the general procedure provided under the Code of Civil Procedure 1908 (CPC). The following sections of the CPC, effectively empower courts to levy costs on the following four different counts:

- section 35: provides that a successful party in litigation should generally be awarded the costs for the litigation and the unsuccessful party should pay the same, however, the levy of general costs is always to the discretion of the court;
- section 35–A: empowers the court to award compensatory costs to a party if:
  - the claim or defence is false or vexatious;
  - objections were made by the other party that the claim or defence was false or vexatious to the knowledge of the party raising it; and
  - this claim was disallowed, withdrawn or abandoned in whole or part;
- section 35–B: empowers the court to levy costs on parties that are causing a delay at any stage of the proceedings; and
- order 20A: empowers courts to levy costs on any of the parties to make payment for any specific expenditure incurred by another party or the court.

Under the 2013 Act and the allied rules thereto, the National Company Law Tribunal (NCLT) is also empowered to levy costs on the following counts.

Section 245 of the 2013 Act provides:

> *where the company fails to comply with an order passed by the NCLT shall be punishable with a minimum fine of [500,000 rupee], and which may extend to 2.5 million [rupee] and every officer of the company who is in default shall be punishable with imprisonment for a term up to three years and with fine which shall not be less than [25,000 rupee] which may extend to [100,000 rupee]; and in case the application is found to be frivolous or vexatious, NCLT may impose cost on the applicant to pay to the opposite party such cost, not exceeding [100,000 rupee].*

The NCLT may, in suitable cases, direct the appellant or respondent to bear the costs of litigation of the other side and, in case of abuse of process of the court, impose exemplary costs on defaulting party.

However, instances of the levy of costs on unsuccessful litigants are rare and costs awarded are usually insufficient to cover the entire cost of litigation.

Privilege

31 | What types of legal privilege exist between litigation funders and litigants?

Answer coming soon.

INVESTMENT FUNDS AND STRUCTURED FINANCE

Interests in investment funds

32 Are there special issues in your jurisdiction with respect to interests in investment funds? What claims are available to investors in a fund against the fund and its directors, and against an investment manager or adviser?

Various kinds of investment funds are used in India (eg, mutual funds, alternative investment funds and real estate investment funds), which are operated through investment trusts. These funds operate in a regulated framework and are governed by the regulations and rules framed by the Securities and Exchange Board of India (SEBI). To safeguard the interests of the investors, SEBI allows investors to file their complaints under the mechanism of the SEBI Complaints Redressal System (SCORES). Under this mechanism, and upon receipt of complaints, SEBI can call upon the funds to resolve the complaint filed by a complainant within a stipulated time frame. However, the SCORES mechanism is, without prejudice to the right of the investors to adopt other civil and criminal remedies, available to members and depositors under the Companies Act 2013 and the Indian Contract Act 1872.

In addition, an investor can also proceed against the trustee on the ground of breach. Section 23 of the Indian Trust Act 1882 provides that a trustee shall be personally liable to the beneficiary of the trust and is liable to make good for the loss sustained by the trust property or the beneficiary. Over time, the courts have held activities such as unauthorised investment of trust money, the realisation of profit from trusts without authority and retaining trust money that should have otherwise been invested as breaches of trust. In addition, to make good the losses, the trustee, in certain circumstances, can also be made liable to pay interest to the beneficiaries, such as on receipt of interest by the trustee:

- when there was an unreasonable delay in paying trust money to the beneficiary;
- when interest has been collected by the trustee;
- when the trustee is fairly presumed to have received interest;
- when the trustee fails to invest trust funds and collect interest on it; and
- when the trustee invested trust money in any business or trade.

However, a trustee cannot be held liable if the beneficiary has induced the trustee to commit the breach by fraud, or the beneficiary, being competent to contract, has concurred in the breach without coercion or undue influence, or has subsequently acquiesced in the breach.

Structured finance vehicles

33 Are there special issues in your country in the structured finance context?

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI) is the primary legislation governing securitisation in India, which generally deals with the mechanism for controlling non-performing assets and controlling them through special purpose vehicles. In addition, the Reserve Bank of India issued the Guidelines on Securitisation of Standard Assets on 1 February 2006, which lays down the regulatory framework in relation to the securitisation of standard assets of banks, financial institutions and non-banking financial companies in India.

SARFAESI is limited in scope as it applies to financial institutions and banks only, and it has been enacted to provide greater control for banks and financial institutions (secured creditors) over the assets of defaulting borrowers and to enable banks and financial institutions to resolve their non-performing assets without the intervention of the courts by transferring their non-performing assets to asset reconstruction companies for management, dealing or disposal and realisation of proceeds.

SARFAESI deals with three distinct concepts:

- the securitisation of financial assets;
- the reconstruction of financial assets of banks and financial institutions; and
- the enforcement of security interests by banks and financial institutions.

SARFAESI contains substantive provisions in relation to these areas.

Risk may arise in relation to the sustained generation of the receivables at certain levels from a number of factors that are beyond the control of the borrower (eg, anticipated reserves may not materialise or seasonal variations in the anticipated levels of receivables). Adequate over-collateralisation may help to mitigate this risk. Further, to protect investors against more sustained long-term declines in the levels of receivables generated, early amortisation triggers are usually built into the transaction that will trigger the repayment of the securities on an accelerated basis if a predefined trigger level is breached.

CROSS-BORDER ISSUES

Foreign claimants and securities

34 What are the requirements for foreign residents or for holders of securities purchased in other jurisdictions to bring a successful claim in your jurisdiction?

To bring a successful claim, foreign investors should be compliant with the regulatory framework prescribed for foreign investments (eg, reporting investments or obtaining prior approval in sectors specified under the foreign direct investment (FDI) policy). Additionally, the holders of securities should not breach the investment limits, if any, prescribed under the FDI policy.

Other than the above, the residency of a holder of securities or the jurisdiction in which he or she has purchased the securities does not affect his or her ability to bring a claim in India. All other recourse set out in our previous responses shall also be available to the non-resident investor. To bring a successful claim, an investor must satisfy the courts that they have jurisdiction as per the provisions of the Code of Civil Procedure 1908 (CPC) to try the matter in dispute before them.

The CPC prescribes that a court can assume jurisdiction if any of the following conditions are met:

- the defendant, at the time of the commencement of the proceedings, resides, carries on business or has an office in India (only the courts within whose local limits the defendant resides, carries on business or has office will have jurisdiction in such a case); or
- the investor establishes that the cause of action, whether wholly or in part, has arisen in India and within the territorial jurisdiction of the court before which he or she proffered his or her claim.

Foreign defendants and issuers

35 What are the requirements for investors to bring a successful claim in your jurisdiction against foreign defendants or issuers of securities traded on a foreign exchange?

To bring a successful claim against a foreign defendant, it is the primary responsibility of the claimant to show that the cause of action arose in India. Further, the courts in India can also assume jurisdiction if the company whose securities are traded on a foreign exchange has a place of business in India.

Multiple cross-border claims

36 How do courts in your jurisdiction deal with multiple securities claims in different jurisdictions?

The right to initiate a proceeding in India always lies with the claimant and there is no law barring different claimants from filing multiple proceedings in similar circumstances before different courts. Courts can stay a proceeding if the issues under consideration are directly and substantially similar to the issues in a previously instituted suit between the same parties before a separate court of competent jurisdiction in terms of section 10 of the CPC. However, if the claim has been filed by multiple claimants before different courts and is against a common defendant in connection with similar facts and circumstances, then the defendant can make an application according to section 22 of the CPC and request the transfer of all the cases before different courts to any one of the courts and, thus, avoid multiple proceedings. Further, courts, in matters involving multiple claims relating to similar facts and circumstances against a common party, can also permit any one of the claimants to file a suit on behalf of all the other claimants in a representative capacity according to order 1, rule 8 of the CPC. The judgment passed in a representative suit under order 1, rule 8 is binding on all the other parties that sought to be represented by the representative suit.

Enforcement of foreign judgments

37 What are the requirements in your jurisdiction to enforce foreign court judgments relating to securities transactions?

A judgment (not being an ex parte judgment) obtained in the foreign courts would, subject to compliance with sections 13 and 44–A of the CPC, be enforced by the courts of India without re-examination of the merits of the case. Section 13 provides that a foreign judgment shall be conclusive as to any matter thereby directly adjudicated upon between the same parties or between parties under which they or any of them claim litigation under the same title, except where:

- the judgment has not been pronounced by a court of competent jurisdiction;
- it has not been given on the merits of the case;
- it appears on the face of the judgment to be founded on an incorrect view of international law or a refusal to recognise the law of India in cases in which this law is applicable;
- the proceedings in which the judgment was obtained are opposed to natural justice;
- it has been obtained by fraud; or
- it sustains a claim founded on a breach of any law in force in India.

Section 44A of the CPC provides that where a foreign judgment has been rendered by a court in any country or territory outside India, with respect to which the government has by a notification declared this territory to be reciprocating territory, the foreign judgment may be permitted to be enforced in India by proceedings in execution as if the judgment had been rendered by the relevant court in India.

ALTERNATIVE DISPUTE RESOLUTION

Options, advantages and disadvantages

38 What alternatives to litigation are available in your jurisdiction to redress losses on securities transactions? What are the advantages and disadvantages of arbitration as compared with litigation in your jurisdiction in securities disputes?

Proceedings for claims under section 35 of the Companies Act 2013 or under the Indian Contract Act 1872 are in the nature of suits, the procedure for which is prescribed in the Code of Civil Procedure 1908 (CPC).

The claimants can also apply to the Securities and Exchange Board of India (SEBI) to investigate the alleged wrongdoings by a company. SEBI has the power to conduct investigations and pass orders prohibiting individuals or entities that were involved in matters pertaining to market manipulation and price rigging, issue-related manipulation, insider trading, takeovers and other matters. In the past, SEBI has also passed directions to issuer companies involved in manipulation relating to issuances, to refund the amount collected from the investors.

The benefit of resolving disputes through arbitration over general court proceedings is that the parties to these disputes are not bound by provisions of the CPC and the Indian Evidence Act 1872, and can decide on the procedure governing the conduct of arbitration as per their convenience. Other benefits include speedy disposal and confidentiality of the proceedings. Additionally, with a view to making arbitration more cost-effective and efficient, the government has introduced the Arbitration and Conciliation (Amendment) Act 2015, which, among other things, requires the arbitral tribunal to render an award within a 12 months of the date the matter was referred to it, with an extension of six months with the parties' consent. Breach of these timelines may incur penalties on the arbitrators by way of reduction of fees. Further, the parties may also agree to a fast-track procedure of arbitration, wherein the tribunal is required to decide the dispute and pass an award within six months of the date of reference. The tribunal shall decide the dispute only on the basis of written pleadings, documents and submissions, and no oral hearing shall be conducted unless requested by both the parties or if called for by the tribunal to seek clarification.

The disadvantages of arbitration are that the arbitral tribunal is not empowered to enforce an award passed by it, and the successful party is required to move to the courts for enforcement of the award. Further, having arbitration in multiparty proceedings does not allow for flexibility when parties do not have an arbitration agreement and for matters involving right in rem.

UPDATE AND TRENDS

Key developments of the past year

39 What are the most significant recent legal developments in securities litigation in your jurisdiction? What are the current issues of note and trends relating to securities litigation in your jurisdiction? What issues do you foresee arising in the next few years?

Whole-time members of the Securities and Exchange Board of India (SEBI) have historically been granted the power to issue orders that are remedial and preventive in nature (eg, disgorgement of undue gains and profits, restriction from accessing securities markets). However, members could not levy any penalties for contravention of securities laws. The power to impose penalties was granted only to adjudicating officers, who conducted separate proceedings for the same violation. These proceedings could run in parallel to each other, thereby causing a duplication of resources, submissions, timelines and efforts in carrying on these proceedings. To address this, certain amendments to the SEBI Act 1992 (SEBI Act) were proposed in the Finance Act 2018, wherein penal powers akin to those of the adjudicating officers were granted to whole-time members to enable them to effectively deal with persons and market players violating securities laws. The amendments to the SEBI Act were made effective on 3 March 2019. Pursuant to this amendment becoming effective, whole-time members were granted the power to impose penalties in addition to orders that are preventive or remedial. These are helpful in reducing multiple parallel proceedings being undertaken by whole-time members and adjudicating officers.

Several high-profile transactions have caused SEBI to focus on the critical role played by auditors, company secretaries, valuers and

market intermediaries, etc. In response, SEBI has been exercising its powers to penalise auditors, merchant bankers and other financial intermediaries for their alleged failure to detect fraud and for their involvement in misstatements in offer documents.

Another interesting trend is the reliance on expert evidence by SEBI in the investigation against the National Stock Exchange of India Limited (NSE) in connection with the NSE's co-location facilities. SEBI had received certain whistle-blower complaints against the NSE and its key officials in 2015 alleging that the NSE was providing a few high-frequency traders and brokers preferential access to its trading platform, giving them an unfair advantage over others. In light of the above, SEBI initiated an investigation and directed the board of directors of the company to initiate an independent forensic audit of the matter. SEBI's investigation and forensic audits by independent experts confirmed the contents of the complaints. Consequently, SEBI issued a show-cause notice to the NSE and its key officials alleging violation of securities laws.

There has also been an increase in the number of settlement orders passed by SEBI. The settlement process provides an efficient resolution for settling cases that can be resolved amicably upon payment of a settlement fee. This significantly reduces litigation and provides a speedier resolution of securities laws violations. The option for settling with confidentiality also provides a key incentive for parties to settle the violation rather than opt for litigation. The settlement fee is computed based on a prescribed formula, and the earlier the violation is disclosed for settlement, the lower the settlement fee. This is a key driving factor for parties opting to settle the violations at the earliest rather than going through the time-consuming and cost-intensive adjudication process.

Further, SEBI has commenced a number of investigations into the leak and the communication of price-sensitive information using internet-based messaging applications. Although listed companies are taking measures to address these issues and avoid future litigation, with the amendments to the SEBI (Prohibition of Insider Trading) Regulations 2015, there is bound to be a greater focus on detection, investigation and enforcement relating to these matters. To this extent, SEBI has also come up with a whistle-blower mechanism, incentivising whistle-blowers with monetary rewards should the information provided lead to disgorgement of undue profits in excess of the prescribed amounts. To regularise the process of dealing with issues of insider trading at the entity level, SEBI has also prescribed reporting formats that each entity must undertake so as to effectively deal with contraventions at the entity level. Based on a review of these reports and the actions undertaken by the entity, SEBI decides whether this contravention and the manner in which it has been handled by the entity is sufficient or whether further action from SEBI is required.

* *The information in this chapter was verified between January and February 2020.*

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GENERAL FRAMEWORK

General climate

1 | Describe the nature and extent of securities litigation in your jurisdiction.

The Financial Instruments and Exchange Act (FIEA) establishes disclosure regulations to secure the accuracy of statements in disclosure documents and to protect investors.

Under the FIEA, an issuer of securities shall be liable for damage suffered by investors who acquired, purchased or sold the securities if the disclosure documents (eg, securities registration statement, prospectus, annual securities reports and quarterly securities reports): (1) contain misstatements regarding material matters; (2) omit statements of material matters that should be stated; or (3) omit statements of material facts that must be stated to avoid causing misunderstanding. The FIEA also prohibits, inter alia, market manipulation and insider trading.

In typical securities litigation, investors bring FIEA claims for alleged material misstatements or omissions against the company (ie, the issuer) following a corrective disclosure that results in a share price drop. They may also bring FIEA claims against the issuer's directors, executive officers, sellers of the securities, auditors (ie, certified public accountant or auditing firm) that certified any financial statements or audits and underwriters for FIEA violations. Private securities litigation claims for insider trading and market manipulation are uncommon.

The FIEA eases a plaintiff's burden of proof in claims against issuers of primary and secondary offerings and in the secondary market. A primary offering is a 'Public Offering of Securities' under Article 2(3), which includes solicitations of applications to acquire newly issued securities (ie, 'Solicitation for Acquisition'). A secondary offering is a 'Secondary Distribution of Securities' under Article 2(4), which includes solicitation of applications to sell or purchase already-issued securities (ie, 'Solicitation for Selling'). The Japanese securities market is divided into a 'primary market' (where securities are issued and distributed) and a 'secondary market' (where securities are bought and sold through the Tokyo Stock Exchange), which includes shares traded after being offered through a public offering or a secondary distribution.

Investors may also assert claims for damages based on the Civil Code and the Companies Act. Such claims are less common, however, in part because of the difficulty in meeting the high burden of proof.

Courts and time frames

2 | What experience do the courts in your jurisdiction have with securities litigation? Are there specialist courts for securities disputes? What is the typical time frame for securities litigation in your jurisdiction?

There are no specific procedural features that are particular to securities litigation, and the proceedings are the same as those in general civil proceedings for damages. After a claimant serves a petition (ie, complaint) and writ of summons on the defendant, the defendant files an answer. The court of first instance (ie, district court) then holds several 'preparatory proceedings' (ie, hearings) to clarify issues. The parties submit briefs with supporting documentary evidence to the court prior to each preparatory proceeding. Court proceedings occur every one or two months. After the parties have submitted documentary evidence and made oral arguments, witnesses are generally called to testify. Thereafter, once the court is satisfied that the various issues have been sufficiently addressed, the court generally will render a judgment within two months. Civil legal proceedings in the district court take less than 12 months (eight months on average), from filing of the petition to trial, but complex cases could take longer. District court decisions are appealable to the High Court. The High Court usually renders a decision within six to 12 months, but could take longer than a year in complex cases. High Court decisions can be appealed to the Supreme Court if the issues concern constitutional violations, lower court procedural breaches and material matters concerning the construction of laws and regulations. The Supreme Court typically renders a decision within four to six months after brief submissions and oral argument.

Government regulation and enforcement

3 | What is the relationship between private securities litigation and government regulation and enforcement in your jurisdiction?

The Financial Services Agency (FSA) and the Securities and Exchange Surveillance Commission (SESC), a committee established within the FSA, enforce the FIEA through investigations of market misconduct and inspections of disclosure requirements. The SESC is responsible for ensuring the fairness and transparency of the markets and for protecting investors. Its oversight function includes:

- conducting investigations of market misconduct, including insider trading and market manipulation;
- conducting inspections of violations in disclosure requirements by listed companies;
- monitoring of violations of laws by financial instruments business operators (FIBOs) (ie, remote offshore trade participants involved in Japanese exchange transactions) and unregistered business operators; and
- making recommendations of administrative actions, administrative monetary penalty payment orders or filing criminal charges in

conjunction with the prosecutor's office. The SESC does not have power to directly prosecute and penalise companies and persons for FIEA violations.

Private securities litigation may be filed in the absence of, in tandem with, or after an SESC or other regulatory investigation. In general, however, private securities litigation arises when: (1) administrative monetary penalties are imposed on the issuer for material misstatements or omissions; and then (2) investors assert claims for damages against the issuer, the issuer's directors, executive officers, auditors or underwriters based on those findings. The administrative authorities' fact-finding or imposition of penalties are not legally binding on the court in private securities litigation, but can serve as a persuasive authority.

CLAIMS AND DEFENCES

Available claims

4 | What types of securities claim are available to investors?

There are three types of claims available to investors in securities litigation: Civil Code claims; Financial Instruments and Exchange Act (FIEA) claims; and Companies Act claims.

For tort liability under the Civil Code, a plaintiff is required to prove:

- the wrongdoer's (eg, the issuer's) intent or negligence;
- causation between tortious conduct (ie, material misstatements or omissions) and the plaintiff's damage; and
- amount of damage.

The amount of damage is considered to be the difference between the purchase price and the sales price (or current value) of the security if the plaintiff establishes that it would not have purchased the security if the material misstatements or omissions in the public filings had been known. However, the plaintiff bears a high burden of proof as each element must be proven.

As a practical matter, given the difficulty in establishing liability under the Civil Code, investors usually bring FIEA claims. In particular, the FIEA eases a plaintiff's burden of proof in claims against issuers of primary and secondary offerings and in the secondary market. Reliance and scienter need not be proven, and damages are presumed. No such presumptions exist, however, for FIEA claims brought against the issuer's directors, executive officers, sellers of the securities, auditors or underwriters.

In addition, investors may assert a claim against the issuer's directors, executive officers or auditors based on the Companies Act. However, investors must meet a high evidentiary burden to establish liability under the Companies Act.

The court system is unified in that there are no different jurisdictions (ie, national versus prefecture or federal versus state).

Offerings versus secondary-market purchases

5 | How do claims (or defences to claims) arising out of securities offerings differ from those based on secondary-market purchases of securities?

The differences between the issuer's liabilities arising out of acquisition of securities in primary or secondary offerings and secondary-market purchases or sales of securities are as follows:

- the nature of liability (strict liability versus negligence);
- the amount of damage (statutory versus presumptive); and
- the statute of limitations period (three or seven years versus two or five years).

Public versus private securities

6 | Are there differences in the claims or defences available for publicly traded securities and for privately issued securities?

Unlike public companies, private companies generally need not issue securities registration statements or disclose annual securities reports or quarterly securities reports under the FIEA. However, if there are material misstatements or omissions in the financial statements or annual business reports required under the Companies Act, the issuer's directors, executive officers or auditors may be liable under the Companies Act or the Civil Code.

Primary elements of claim

7 | What are the elements of the main types of securities claim?

Claims against the issuer – primary and secondary offerings

Under the FIEA, when an investor asserts a claim against the issuer arising out of the acquisition of the securities in primary or secondary offerings, the investor must only establish the existence of the material misstatements or omissions in the securities registration statement and the investor's acquisition of the securities in primary or secondary offerings. The investor is not required to establish the amount of damage incurred or causation between the material misstatements or omissions and the damage. The amount of damage is assessed in accordance with statute, as set out in the formula in the FIEA.

Claims against the issuer – secondary market

Under the FIEA, when an investor asserts a claim against the issuer arising out of secondary-market purchases or sales of the securities, the investor must only establish: (1) the existence of the material misstatements or omissions in the disclosure documents; and (2) the investor's purchase or sale of the securities on the secondary market. The investor is not required to establish: (3) the amount of damage incurred; or (4) causation between the material misstatements or omissions and the damage. The amount of damage is presumed under certain circumstances and the formula is set out in the FIEA.

Claims against others

Under the FIEA, when an investor asserts a claim against the issuer's directors, executive officers, sellers of the securities, auditors or underwriters, the investor bears the burden of establishing items (1) to (4), as discussed above.

Primary defences

8 | What are the most commonly asserted defences? Which are typically successful?

For FIEA claims, the issuer, the issuer's directors, executive officers, sellers of the securities, auditors or underwriters will not be liable if the investor knew of the material misstatements or omissions when acquiring, purchasing or selling the securities. In that case, causation between the material misstatements or omissions and damage is lacking. However, a defendant bears the burden of proof (ie, the investor need not prove that it lacked awareness of the falsity).

In addition, the FIEA provides that if the issuer proves that all, or part, of the investor's loss was caused by reasons other than the material misstatements or omissions, the issuer is not liable for all or part of the investor's damage because causation is lacking. The issuer bears the burden of proof.

Further, as to the damage of an investor who purchased the securities on the secondary market, the FIEA provides that if events other than the material misstatements or omissions caused the decline but the amount of decline attributable to those events is extremely difficult for

the issuer to establish, the court has the discretion to reduce damages accordingly.

Materiality

9 What is the standard for determining whether the misstated or omitted information is of sufficient importance to be actionable?

'Material' is considered to be matters or facts that influence investors' decisions and price formation of the securities on the market. According to the case law, 'material' is not the specific or subjective importance to the investor who asserts a claim (ie, whether the information was actually important for the particular investor is irrelevant), but rather the abstract and objective importance to investors in general and the market in particular.

As long as the information is 'material' for market price formation, an investor suffers harm even if the investor did not find specific or subjective importance to the information. This is similar to the 'fraud on the market' theory in the United States (ie, the market price of shares impounds all publicly available information, including material misrepresentations).

Scienter

10 What is the standard for determining whether a defendant has a culpable state of mind to support liability? What types of allegation or evidence are typically advanced to support or defeat state-of-mind requirements?

Claims against the issuer – primary and secondary offerings
Under the FIEA, the issuer will be strictly liable to investors who acquired the securities in primary or secondary offerings for the material misstatements or omissions in its securities registration statement.

Claims against the issuer – secondary market
Under the FIEA, if the issuer proves that it had no intent or negligence concerning the material misstatements or omissions in the disclosure documents, the issuer will not be liable to investors who purchased or sold the securities on the secondary market.

Claims against others
Under the FIEA, if the issuer's directors, executive officers, sellers of the securities, auditors or underwriters prove that they had no intent or negligence concerning the material misstatements or omissions in the disclosure documents, they will not be liable to investors who acquired the securities in primary or secondary offerings or purchased or sold the securities on the secondary market.

Reliance

11 Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

Under the FIEA, an investor who asserts a claim based on material misstatements or omissions is not required to prove that the investor relied on the disclosure documents when the investor acquired, purchased or sold the securities.

As long as the price is erroneously formed based on the material misstatements or omissions, there is causation between the material misstatements or omissions and damage even if the investor did not actually review the disclosure documents. This is similar to the 'fraud on the market theory' in the United States.

However, if the investor knew of the material misstatements or omissions, the issuer, the issuer's directors, executive officers, sellers of the securities, auditors or underwriters will not be liable for damages. In that case, causation between the material misstatements and the damage is lacking.

Causation

12 Is proof of causation required? How is causation established? How is causation rebutted?

Claims against the issuer – primary and secondary offerings
Under the FIEA, an investor is not required to establish that the actionable misconduct was the cause of economic losses to the investors.

Claims against the issuer – secondary market
Similarly, investors with claims against issuers in the secondary market need not establish loss causation.

Claims against others
Under the FIEA, when an investor asserts a claim against the issuer's directors, executive officers, sellers of the securities, auditors or underwriters, the investor bears the burden of establishing not only the existence of the material misstatements or omissions and the investor's acquisition, purchase or sale of the securities, but also the amount of damage incurred and causation between the material misstatements or omissions and the damage. A defendant can rebut causation by showing that some or all of the price decline was not the result of any purported material misstatements or omissions, but some other market factor.

Other elements of claim

13 What elements or defences present special issues in the securities litigation context?

The FIEA provides the following special provisions in regard to the amount of damage.

Claims against the issuer – primary and secondary offerings
The amount of damage is assessed in accordance with statute, as set out in the formula in the FIEA. It is calculated as the amount paid by the investor minus:

- the market price of the securities at the time of asserting a claim (or the estimated disposal price at the time of asserting a claim if no market price is available); or
- the disposal price, in the case where the investor sold the securities before asserting a claim.

Claims against the issuer – secondary market
Under the FIEA, the amount of damage suffered by the investor who purchased the securities within one year before the disclosure date of the material misstatements or omissions and continues to hold the securities on the disclosure date is presumed to be:

- the average market price (or the estimated disposal price if no market price is available) of the securities over one month before the relevant disclosure date, minus
- the average market price (or the estimated disposal price if no market price is available) of the securities over one month after the relevant disclosure date.

The investor is allowed to establish that the damages are beyond the presumed amount. However, such established damages must not exceed the amounts below (because, under the FIEA, the damages of investors who purchased the securities on the secondary market should not exceed the damages of investors who acquired the securities in primary or secondary offerings). Such damages are calculated as the amount paid by the investors, minus:

- the market price of the securities at the time of asserting a claim (or the estimated disposal price at the time of asserting a claim if no market price is available); or
- the disposal price, if the investor sold the securities before asserting a claim.

Claims against others

When an investor asserts a claim against the issuer's directors, executive officers, sellers of the securities, auditors or underwriters, the investor bears the burden of establishing the amount of damage.

Limitation period

14 What is the relevant period of limitation or repose? When does it begin to run? Can it be extended or shortened?

Claims against the issuer – primary and secondary offerings

Under the FIEA, the right to claim damages extinguishes if it is not exercised within three years of the time when the investor comes to know or should have been able to know the material misstatements or omissions if exercising reasonable care. Also, a claim extinguishes when it has not been exercised for seven years after the securities registration statement comes into effect.

Claims against the issuer – secondary market

Under the FIEA, a claim extinguishes if it is not exercised for two years from the time when the investor comes to know or should have been able to know the material misstatements or omissions if exercising reasonable care. Also, a claim extinguishes when it has not been exercised for five years after the disclosure documents are filed or submitted.

Claims against others

The FIEA provides no particular provisions regarding the statute of limitations for a claim against the issuer's directors, executive officers, sellers of the securities, auditors or underwriters based on the material misstatements or omissions. Accordingly, the Civil Code, which provides the statute of limitations for torts, applies as the default rule. A tort claim extinguishes if it is not exercised within three years of the time when an investor who acquired, purchased or sold the securities learns of the damage, or due to a period of exclusion 20 years after the time of the material misstatements or omissions.

REMEDIES, PLEADING AND EVIDENCE

Remedies

15 What remedies are available? Do any defences present special issues in the context of securities litigation? What is the measure of damages and how are damages proven?

The remedy available for claims under the Financial Instruments and Exchange Act (FIEA), the Civil Code and the Companies Act is monetary compensation. Punitive damages are not allowed under Japanese law.

In principle, the amount of damage is assessed by comparing the investor's hypothetical financial condition if there had been no material misstatements or omissions and the investor's actual financial condition. However, if factors other than the misstatements or omissions, in whole or in part, caused the price decline, then the proportion attributable to those factors will be deducted from the damages.

Pleading requirements

16 What is required to plead the claim adequately and proceed past the initial pleading?

There are no pleading requirements and a motion to dismiss is not available in Japanese civil lawsuits. However, if the complaint fails to adequately and properly plead all required elements of the claim and the plaintiff fails to make appropriate corrections despite receiving a court order to do so within the time given to the plaintiff, the court must dismiss the complaint.

Procedural defence mechanisms

17 What are the procedural mechanisms available to defendants to defeat, dispose of or narrow claims at an early stage of proceedings? What requirements must be satisfied to obtain each form of pretrial resolution?

There are no procedural mechanisms available to defendants to dismiss claims at an early stage of the proceedings. However, if a plaintiff asserts a claim that the court considers to be inadequately pleaded or without merit, the court may instruct the plaintiff to cure or dismiss the claim.

Evidence

18 How is evidence collected and submitted to the court to support securities claims and defences in your jurisdiction? What rules and common practices apply to the introduction of expert evidence and how receptive are courts to such evidence?

Japan does not have a system of broad and compulsory discovery procedures equivalent to those in other common law jurisdictions such as the United States. However, under the Code of Civil Procedure, courts have discretion to order: (1) production of documents sua sponte or upon a petition from a party; (2) examination of the parties' witnesses through written statements or orally before the court; and (3) discovery from third parties. If a party fails to comply with a court order, the court may deem the allegation pertaining to the related evidence as true. The court may also issue a civil fine against the non-complying party. The combination of court-controlled evidence production and numerous short hearings over extended periods serves as a substitute for US-style pretrial discovery. Because a plaintiff need not prove intent or negligence in FIEA claims against the issuer, the limitation on discovery is generally not considered a significant hurdle. In fact, it can result in lessening legal costs.

In principle, each side collects evidence to support its claims or defences for submission to the court. Nevertheless, if particular documents are necessary to the case for good reason and in the possession of the counterparty or third party, the party seeking discovery may petition the court to order the production of those documents.

Expert evidence is permitted. Experts may be appointed by the court or the parties. Expert witnesses and opinions are proffered in the same way as ordinary evidence. The court will decide whether to accept expert evidence considering the time and necessity to the case.

LIABILITY

Primary liability

19 Who may be primarily liable for securities law violations in your jurisdiction?

The issuer's directors, executive officers and 'equivalent persons' may be liable for the damage caused by the material misstatements or omissions. These persons are usually in a leading position regarding the material misstatements or omissions, and therefore are subject to

liability. According to case law, 'equivalent persons' are those persons that are given a position and authority almost equivalent to that of a director who manages the issuer's business.

Secondary liability

20 | Are the principles of secondary, vicarious or 'controlling person' liability recognised in your jurisdiction?

The principles of secondary, vicarious or 'controlling person' liability are not recognised under the Financial Instruments and Exchange Act (FIEA) or Companies Act.

In the Civil Code, vicarious liability is recognised, and investors may pursue claims accordingly. Investors are required to prove:

- the wrongdoer's (employee's) intent or negligence;
- causation between the tortious conduct and damage;
- the amount of damage;
- the employment relationship with the wrongdoer; and
- the tortious conduct was made in regard to the employer's business.

Claims against directors

21 | What are the special issues in your jurisdiction with respect to securities claims against directors?

Under the FIEA, if the disclosure documents contain material misstatements or omissions, the issuer's directors are liable for damage suffered by investors who acquired, purchased or sold the securities. However, the directors may be relieved from liability if they prove that they did not know and could not know that there were material misstatements or omissions even if exercising reasonable care. This is similar to the due diligence defence in the United States. Also, the issuer's directors may be relieved from liability if they prove that the investor knew of the material misstatements or omissions at the time of acquisition, purchase or sale of the securities.

The issuer's directors may be liable under the Companies Act and the Civil Code based on the material misstatements or omissions.

Claims against underwriters

22 | What are the special issues in your jurisdiction with respect to securities claims against underwriters?

Under the FIEA, if a securities registration statement contains material misstatements or omissions, underwriters are liable for damage suffered by investors who acquired the securities in the primary or secondary offering. However, underwriters may be relieved from the liability if they prove that:

- where the financial accounting section of the securities registration statement contains material misstatements or omissions, they did not know of such material misstatements or omissions; or
- where sections other than the financial accounting section of the securities registration statement contains material misstatements or omissions, they did not know of such material misstatements or omissions even if exercising reasonable care.

This is similar to the due diligence defence in the United States. Also, the underwriters may be relieved from liability if they prove that the investor knew of the material misstatements or omissions at the time of acquisition of the securities.

Under the current Japanese practice, issuers virtually cannot access the capital markets without services providers such as underwriters or auditors. Such professionals are expected to act as gatekeepers when issuers enter the capital market. By imposing the potential for civil liability on them, the issuer's disclosures in theory will be scrutinised more carefully.

Claims against auditors

23 | What are the special issues in your jurisdiction with respect to securities claims against auditors?

Under the FIEA, if financial statements (including balance sheets, profit and loss statements and other documents concerning statements on finance and accounting) pertaining to the disclosure documents contain the misstatements or omissions and the auditor has certified that there are no misstatements or omissions therein, the auditor is liable for the misstatements or omissions.

However, the auditor may be relieved from liability if it proves that it did not provide such incorrect certification intentionally or negligently, or the investor knew of the misstatements or omissions.

COLLECTIVE PROCEEDINGS

Availability

24 | In what circumstances does your jurisdiction allow collective proceedings?

There is no class action system in Japan such as in the United States. Plaintiffs in securities litigation have brought claims as a group in the form of representative actions or through joinder of claims under the Code of Civil Procedure. These procedures permit consolidation of separate lawsuits and collective adjudication of claims where the obligations or liabilities are common to the investors and are based on the same facts or law.

In 2013, the Act on Special Provisions of Civil Procedure for Collective Recovery of Consumers' Property Damage (ASPCP), which provides a two-tier, opt-in procedure for group litigation for matters involving consumer contracts, was enacted. However, the ASPCP does not apply to Financial Instruments and Exchange Act claims. Under the ASPCP, only specified qualified consumer organisations (SQCOs), which are certified by the Prime Minister of Japan, may bring consumer collective actions. During the first stage (ie, common obligation confirmation proceedings), the SQCO files a lawsuit requesting confirmation of common obligations, which are obligations of the defendant (ie, business operator) to compensate consumers based on factual and legal issues common to a group of consumers. In other words, consumers themselves cannot bring collective actions under the ASPCP. If the court confirms the common obligations, then consumers can opt in to the proceeding (ie, claim determination proceedings) by delegating the SQCO to file claims for damages with the court.

Claims subject to common obligation confirmation proceedings are limited to the following monetary claims in relation to a consumer contract for property damage suffered by a considerable number of consumers: (1) claims for performance of contractual obligation; (2) claims for unjust enrichment; (3) claims for non-performance of a contractual obligation; and (4) claims based on tort under the Civil Code.

Reliance, causation and damages

25 | Can reliance, causation and damages be determined on a class-wide basis, or must they be assessed individually?

Under the ASPCP, each consumer's amount of damage must be assessed individually.

Court involvement and procedure

26 What is the involvement of the court in collective proceedings and what procedures must be followed to achieve collective treatment of claims? What is the procedure for settling collective proceedings and what is the extent of the court's involvement in settlement?

There is no class action system in Japan like, for example, in the United States. Plaintiffs in securities litigation have brought claims as a group in the form of representative actions or through joinder of claims under the Code of Civil Procedure. These procedures permit consolidation of separate lawsuits and collective adjudication of claims where the obligations or liabilities are common to the investors and are based on the same facts or law.

In 2013, the ASPCP, which provides a two-tier, opt-in procedure for group litigation for matters involving consumer contracts, was enacted. However, the ASPCP does not apply to Financial Instruments and Exchange Act claims.

Under the ASPCP, only SQCOs, which are certified by the Prime Minister of Japan, may bring consumer collective actions. During the first stage (ie, common obligation confirmation proceedings), the SQCO files a lawsuit requesting for confirmation of common obligations, which are obligations of the defendant (ie, business operator) to compensate consumers based on factual and legal issues common to a group of consumers. In other words, consumers themselves cannot bring collective actions under the ASPCP. If the court confirms the common obligations, then consumers can opt-in the proceeding (ie, claim determination proceedings) by delegating the SQCO to file claims for damages with the court.

Claims subject to common obligation confirmation proceedings are limited to the following monetary claims in relation to a consumer contract for property damage suffered by a considerable number of consumers: (1) claims for performance of contractual obligation; (2) claims for unjust enrichment; (3) claims for non-performance of a contractual obligation; and (4) claims based on tort under the Civil Code.

Opt-in/opt-out

27 In collective proceedings, are claims opt-in or opt-out?

The ASPCP adopts 'opt-in' collective proceedings. For consumers to be compensated, each consumer must file its claim with the SQCO in the second stage of the proceedings.

Regulator and third-party involvement

28 What role do regulators, professional bodies and other third parties play in collective proceedings?

The Prime Minister of Japan certifies entities to become SQCOs, which may bring consumer collective actions under the ASPCP.

FUNDING AND COSTS

Claim funding

29 What options are available for plaintiffs to obtain funding for their claims? What are the pros and cons of each option, including any ethical issues relating to litigation funding?

Contingency fee arrangements are permitted in Japan. Separately, although civil legal aid provides support (such as advance payment of attorneys' fees) for indigent parties, civil legal aid is different from litigation funding (third-party funding). There are no general rules aimed at addressing third-party funding. In other words, no law directly prohibits third-party funding, but no law explicitly permits it. Nor has the issue been addressed by the courts.

Costs

30 Who is liable to pay costs in securities litigation? How are they calculated? Are there other procedural issues relevant to costs?

There are no special rules regarding liability for costs in securities litigation. In general, the losing party bears litigation costs, including fees paid for the revenue stamp, which is affixed to a complaint or other petition, court filing fees, postage for sending documents and daily allowance for witnesses. On the other hand, each party generally bears its own attorneys' fees.

Under the Code of Civil Procedure, the court must, upon the petition by the defendant, order the plaintiff to provide security for the litigation costs if the plaintiff lacks a residence or business office in Japan.

Privilege

31 What types of legal privilege exist between litigation funders and litigants?

There are no general rules aimed at addressing litigation funding including whether legal privilege exists between the funder and litigants. In principle, Japanese law provides no protection for attorney–client communications. However, the Attorney Act provides that a lawyer or a former lawyer shall have the right and the obligation to maintain the confidentiality of any facts, which they may have learned during the course of performing their duties. Moreover, ethical rules for practising attorneys provide that if a lawyer discloses client information to others or violates the lawyer's confidentiality obligation, the lawyer could be disciplined by the Bar Association.

INVESTMENT FUNDS AND STRUCTURED FINANCE

Interests in investment funds

32 Are there special issues in your jurisdiction with respect to interests in investment funds? What claims are available to investors in a fund against the fund and its directors, and against an investment manager or adviser?

Various types of investment vehicles, such as investment trusts and private equity funds, are used in Japan. Real estate investment trusts and infrastructure funds are listed and traded on the stock exchange market.

An investor may assert a claim for damages against such entities as the settlor companies and trustee companies of investment trusts, the fund managers, the managing partners of partnerships under the Civil Code or investment business limited partnerships and the business operators of anonymous partnership for breach of fiduciary duties.

Structured finance vehicles

33 Are there special issues in your country in the structured finance context?

Various types of structured finance such as asset-backed securitisations are used in Japan. Asset-backed securitisations may take place through such entities as a specific purpose company, limited liability company, a specific purpose trust or anonymous partnership. The types of receivables that are commonly securitised in practice include receivables on loans secured by residential mortgages, credit card receivables, lease receivables, auto-loan receivables and account receivables, which include promissory notes. Real estate is another type of asset commonly securitised in Japan. Asset-backed securities are typically traded on the private market.

An investor may assert a claim against such entities as the directors of special purpose companies, the managing members of limited

liability companies, the trustee companies of trusts and the business operators of anonymous partnership for breach of fiduciary duties.

CROSS-BORDER ISSUES

Foreign claimants and securities

34 What are the requirements for foreign residents or for holders of securities purchased in other jurisdictions to bring a successful claim in your jurisdiction?

Under the Code of Civil Procedure, the Japanese courts have jurisdiction over an action that is brought against a corporation whose principal office or business office is located in Japan; and a person domiciled in Japan.

Accordingly, any claimant, regardless of such claimant's domicile, may commence securities litigation in a Japanese court so long as the principal office or business office of the issuer is located in Japan or the issuer's directors and others are domiciled in Japan.

Foreign defendants and issuers

35 What are the requirements for investors to bring a successful claim in your jurisdiction against foreign defendants or issuers of securities traded on a foreign exchange?

Under the Code of Civil Procedure, the Japanese courts have jurisdiction over an action that is brought against a corporation whose principal office or business office is located in Japan; and a person domiciled in Japan.

Accordingly, any claimant, regardless of such claimant's domicile, may commence securities litigation in a Japanese court so long as the principal office or business office of the issuer is located in Japan or the issuer's directors and others are domiciled in Japan.

However, claims against foreign issuers are rare, as there are only a handful of single-listed foreign companies on the stock exchanges in Japan.

Multiple cross-border claims

36 How do courts in your jurisdiction deal with multiple securities claims in different jurisdictions?

There are no different jurisdictions (ie, national versus prefecture or federal versus state) or systems similar to multi-district litigation within Japan. Multiple filings of securities claims arising from the same material misstatements or omissions can be filed with different district courts and each case will be handled separately in general.

Enforcement of foreign judgments

37 What are the requirements in your jurisdiction to enforce foreign court judgments relating to securities transactions?

The Code of Civil Procedure and the Civil Execution Act set out the requirements and procedures for recognising and enforcing a foreign court judgment. Japan is not a party to any bilateral or multilateral treaties for the reciprocal recognition and enforcement of foreign judgments such as the Hague Convention on Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters.

Under the Code of Civil Procedure, the requirements for recognising a foreign judgment are: (1) the jurisdiction of a foreign court is recognised pursuant to laws and regulations, conventions or treaties; (2) the losing party has been served (excluding service by publication or any other similar service) with the requisite summons or order for the commencement of litigation, or has appeared without being so served; (3) the content of the judgment and the litigation proceedings are not contrary to the public policy in Japan; and (4) there exists reciprocity between Japan and the foreign country rendering the judgment treats Japanese judgments similarly.

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The foreign judgment also must be final and binding (ie, judgment cannot be appealed based on existing procedures in the foreign country of judgment).

A court will determine whether these requirements are satisfied in an action for 'execution judgment' under the Civil Execution Act. If an execution judgment is obtained, the underlying foreign judgment will be enforceable in Japan.

There are no special rules for the recognition and enforcement of a foreign judgment relating to securities transactions.

ALTERNATIVE DISPUTE RESOLUTION

Options, advantages and disadvantages

38 What alternatives to litigation are available in your jurisdiction to redress losses on securities transactions? What are the advantages and disadvantages of arbitration as compared with litigation in your jurisdiction in securities disputes?

Disputes arising from the material misstatements or omissions may be resolved through a civil conciliation procedure (similar to mediation in the United States) and arbitration. However, arbitration is usually not an option to resolve disputes relating to a securities claim under the Financial Instruments and Exchange Act or a tort claim under the Civil Code. This is because an arbitration agreement would not exist between the plaintiff (investors) and defendants (issuer, issuer's directors, executive officers, sellers of the securities, auditors or underwriters).

UPDATE AND TRENDS

Key developments of the past year

39 What are the most significant recent legal developments in securities litigation in your jurisdiction? What are the current issues of note and trends relating to securities litigation in your jurisdiction? What issues do you foresee arising in the next few years?

On 22 December 2020, in a case of first impression, the Supreme Court held that the lead underwriter of an initial public offering (IPO) was liable for damages arising from material misstatements in the financial accounting section of a securities registration statement. The Supreme Court's decision clarifies that an underwriter may be

obligated to investigate and confirm the accuracy of financials (ie, financial accounting section of a securities registration statement), even if certified by an auditor, and will likely have a significant impact on the securities practice as it expands underwriter liability in public offerings.

FOI Corporation (the company), a semi-conductor production equipment maker, filed a securities registration statement and delivered a prospectus with material misstatements. The misstatements were not uncovered during the certified public accountant's audit, the underwriter's due diligence or the stock exchange's examination. Roughly six months after the IPO, the window-dressing accounting was revealed. Shortly thereafter, the company commenced bankruptcy proceedings and then delisted. Shareholders brought a lawsuit for damages under the Financial Instruments and Exchange Act (FIEA), the Companies Act and the Civil Code against, among others, the company's directors, the auditor, underwriters and the stock exchange.

The district court held that the lead underwriter was liable for the material misstatements under the FIEA. On appeal, the High Court ruled that the lead underwriter was not liable, despite the fact that the lead underwriter received two anonymous whistleblower tips about the material misstatements during the underwriting examination.

Investors appealed to the Supreme Court. In overturning the High Court judgment, the Supreme Court held that:

- an underwriter has a duty to investigate and confirm the accuracy of a securities registration statement's financial accounting section even if an auditor audited that section, where the underwriter receives information that casts significant doubt on the basic reliability of the audit; and
- as a result, the defendant-lead underwriter was not relieved from liability under the FIEA because the lead underwriter did not conduct a good enough investigation or seek confirmation as to the accuracy of the financial accounting, and thus failed to prove that it was unaware the financial accounting section contained material misstatements.

Luxembourg

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GENERAL FRAMEWORK

General climate

1 Describe the nature and extent of securities litigation in your jurisdiction.

With respect to the prospectus regime, the current Luxembourg framework is provided in:

- Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing EU Directive 2003/71; and
- the Luxembourg law dated 16 July 2019 relating to prospectuses for securities (the Prospectus Law), supplementing and implementing Regulation (EU) 2017/1129.

The Prospectus Law provides for a distinction between two situations.

First, for prospectuses for the public offering or the listing on a regulated market of securities covered by Regulation (EU) 2017/1129, they are covered by articles 4 to 15 of the Prospectus Law; in particular article 5, which provides that:

> *The responsibility for the information provided in a prospectus and in any supplement thereto lies with the issuer, the offeror, the person asking for admission to trading on a regulated market or the guarantor, as the case may be. The prospectus (…) shall contain a statement by [the persons responsible] that, to the best of their knowledge, the information contained in the prospectus is in accordance with the facts and contains no omission likely to affect its import.*

and that:

> *No civil liability shall attach to any person solely on the basis of the summary provided (…), except: 1° if its content is misleading, inaccurate or inconsistent, read in combination with other parts of the prospectus; or 2° if it does not provide, read in combination with the other parts of the prospectus, key information to assist investors when considering investing in the securities.*

Second, for prospectuses for the public offering or the listing on a regulated market of securities *not* covered by EU Regulation 2017/1129, they are covered by article 16 et seq of the Prospectus Law, with an identical liability rule; in particular article 23, which provides that:

> *Responsibility for the information provided in a short form prospectus and any supplement thereto is the responsibility of the issuer or the offeror or guarantor, as the case may be. The short form prospectus (…) contains a statement by [the persons responsible] that, to the best of their knowledge, the information contained in the simplified prospectus are in accordance with reality and do not contain any omissions likely to alter its scope.*

Third, sanctions can be pronounced by the Luxembourg financial sector authority the Financial Sector Supervisory Commission (CSSF). Under articles 12 and 35 of the Prospectus Law, in the case of publication of false information in a prospectus or a supplement to the prospectus (including a short-form prospectus), the CSSF may impose administrative sanctions and take administrative measures such as a public statement on the infringement, an injunction or administrative fines on legal or natural persons – which can be of a considerable amount as calculated on the benefit from the false information.

This framework must be read together with the European Securities and Markets Authority Q&A (version 6 dated 21 January 2021), with the CSSF's Q&A (which is, however, not updated), and with the CSSF's latest instructions and procedures for the e-filing of prospectuses.

In addition to the liability related to prospectuses, issuers whose securities are listed on a regulated market may face liability in relation to the information that they publish for the purposes of the transparency regime, implemented in Luxembourg by the law dated 11 January 2008 on issuers' transparency obligations, as amended (the Transparency Law). Under this law, issuers are to publish three main series of periodic information, namely their annual and half-year financial reports and, as the case may be, sums paid to governments (articles 3, 4 and 5). The responsibility and liability in this respect are obviously on the issuer itself, as per article 6 of the Transparency Law. With respect to continuous information, the publication and declaration information being in all-but-one cases on holders of securities, the liability is not on the issuer. The obligation to declare the amendments of the rights attached to the securities issued (article 15) is, though, on the issuer (article 6). In these respects as well, the CSSF has the power to pronounce sanctions (article 22 of the Transparency Law).

Interestingly, this Transparency Law framework should be read in conjunction with the CSSF Circular 08/337, as amended, which clarifies that an issuer may either file its regulated information itself or appoint a third party to execute the filing in its name and on its behalf, but will nevertheless remain entirely and solely responsible under the obligations that the Transparency Law imposes on it.

Finally, in addition to these main pieces of legislation and regulation, and without being exhaustive, other regimes will be relevant to Luxembourg securities litigation, whether for listed securities or non-listed securities:

- the EU Regulation 2017/2402, laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation is relevant here although it is not specifically a Luxembourg legislation. It contains an important number of obligations and liabilities for the issuers of asset-backed securities (ABS) falling within its limited scope, but also on originators and sponsors. In particular, a risk of liability

exists in relation to the use of the designation 'simple, transparent and standardised securitisation' where it is not – or no longer – accurate (article 18 et seq).

- On a related topic, the Luxembourg law dated 22 March 2004 on securitisation, as amended, is of relevance, although it does not contain any provisions with respect to liability. It must be read together with the Q&A of the CCSF on securitisation.
- The Luxembourg law dated 27 July 2003 on fiduciary arrangements is also of relevance, insofar as it has been heavily used in the past to issue ABS under the form of fiduciary notes, characterised, exactly as instruments issued by a securitisation vehicle, by limited recourse and non-petition rights, which the Luxembourg courts strongly enforce.
- The rules and regulations of the Luxembourg Stock Exchange (LSE) provide, for the issue of securities on the non-regulated market of the LSE (called the Euro MTF market), for a disclosure and ongoing liability regime, which is comparable, in its principles, to the prospectus and transparency regimes, though less stringent.
- The Luxembourg law dated 24 May 2011 on the exercise of their rights by shareholders of listed companies, is relevant as it includes requirements for shareholders information and a (rare) express statement of the principle of equality between shareholders of the same category.
- The absolutely central Luxembourg law dated 10 August 1915 on commercial companies, as amended, is the keystone of any and all securities litigation in Luxembourg. It contains the rules under which Luxembourg issuers can issue securities, be they equity securities (shares) or debt securities (bonds, notes or certificates). It also contains the principles relating to the political (information, participation) and financial rights of the holders of these securities.
- The Luxembourg law dated 1 August 2001 on the circulation of securities does not contain any rules with respect to issuers' liability, but it does provide principles regulating the practical and technical aspects of the holding on securities, including as book entries, as dematerialised securities, and since recently as block-chain tokens. It provides for cases where a holder of securities can be liable as acquirer towards another legitimate holder (article 12).
- For financial services providers involved in the issue, marketing or holding of securities, the law dated 5 April 1993 on the financial sector, as amended, contains their status.
- Due to the presence in Luxembourg of central securities depository Clearstream, claims and disputes relating to securities held through the clearing system, which will trigger the application of the Clearstream rules, are often also covered by Luxembourg law in furtherance of the *lex rei sitae* principle.
- Lastly, the Luxembourg Civil Code is an important element in securities litigation, for three reasons. First, it contains the principles of extra contractual liability (articles 1382 et seq). Second, it contains the principles of contractual liability (article 1134 et seq). Third, it is on the basis of its general principles that Luxembourg case law has created an exhaustive set of duties, obligations and good faith requirements, which are key to assess any claims based on reliance, misrepresentation, loss of chance, management liability and of the prejudice related thereto.

Courts and time frames

2 | What experience do the courts in your jurisdiction have with securities litigation? Are there specialist courts for securities disputes? What is the typical time frame for securities litigation in your jurisdiction?

Luxembourg courts are often the forum of securities disputes; as a financial centre, an important number of securities are governed by Luxembourg law and under the jurisdiction of Luxembourg courts. This is true for listed and non-listed securities, but with a major focus on debt rather than equity securities. Luxembourg courts are also experienced with ABS. There is no specialist court for securities in Luxembourg. The commercial formation of the ordinary district court is hence competent by default, with the exception of summary cases (*référés*, before the court's president), and justices of the peace for disputes on amounts lower than €10k. For a regular oral procedure, a delay of three to six months can be expected between the filing and the pleading, while for more technical cases a written, longer procedure is available. The covid pandemic has made these delays less predictable.

Government regulation and enforcement

3 | What is the relationship between private securities litigation and government regulation and enforcement in your jurisdiction?

In principle, the enforcement of rules and the sanctioning of issuers or other actors is entrusted to the public authorities (ie, the CSSF), while questions of liability and compensation are entrusted to the commercial court system. It is worth noting that at the crossroad thereof, there is the LSE, which is a private company and has a regulating role on the market on which it operates. One important element in relation to the interoperation of public and private enforcements is that private enforcement of liability is generally based on concepts of faults, which are easier to evidence before courts in situations where the public authorities have sanctioned a market player or issuer. In particular, the liability of company management (towards the company or towards third parties) is partially built on the concept of legal breach.

CLAIMS AND DEFENCES

Available claims

4 | What types of securities claim are available to investors?

The majority of private claims are compensation claims based on the rules of civil or contractual liability under the Luxembourg Civil Code. In addition, a number of cases, often summary cases, are initiated by investors who ask for further information. This is notably the case for asset-backed securities and securitisations, where investors try to obtain more information on the underlying portfolio and its performance. Also, more generally, private litigation will revolve around requests for enforcement measures (forced payment, specific performance or delivery in kind, provision of information or documents, termination of agreements, injunctions, seizing orders or forced convening of meetings), including for a large part summary proceedings.

There are no separate sets of state and federal laws in Luxembourg.

In theory, the liability of the management of a securities issuer could be raised by third parties. This is, however, more a theoretical possibility given that the liability of the management towards third parties would require either a legal breach (the violation of specific corporate laws or of the articles of association of the company) or a fault that would be separate from the functions of the managers.

Offerings versus secondary-market purchases

5 | How do claims (or defences to claims) arising out of securities offerings differ from those based on secondary-market purchases of securities?

Luxembourg law does not address these differently.

Public versus private securities

6 | Are there differences in the claims or defences available for publicly traded securities and for privately issued securities?

There are no separate sets of principles with respect to liability or compensation in this respect. However, two elements are important to note.

First, the fact that a number of laws and regulations on disclosure and transparency apply to listed securities only (including the rules and regulations of the Luxembourg Stock Exchange for the non-regulated market known as Euro MTF) necessarily increases the number of faults that can be reproached to issuers or other actors in this respect.

Second, the Luxembourg Prospectus Law does provide a specific ground for liability in relation to the content of a prospectus drawn for the listing of securities on a regulated market or their offer to the public.

Primary elements of claim

7 | What are the elements of the main types of securities claim?

The main elements of liability are a fault, a prejudice and a causation link between them.

Primary defences

8 | What are the most commonly asserted defences? Which are typically successful?

The main defences will be based on the absence of fault, the absence of prejudice or the absence of causation.

Materiality

9 | What is the standard for determining whether the misstated or omitted information is of sufficient importance to be actionable?

There is no such materiality threshold with respect to the importance of the information under Luxembourg law.

Scienter

10 | What is the standard for determining whether a defendant has a culpable state of mind to support liability? What types of allegation or evidence are typically advanced to support or defeat state-of-mind requirements?

Luxembourg law does not provide for a level of culpability or mens rea or intent in this respect. Negligence is itself enough to trigger liability under civil law. The degree of seriousness of a fault can, however, have an impact on the level of compensation, as well as the effect of potential limitations or exclusions of liability. Luxembourg case law provides distinctions between simple fault, serious fault and intentional fault.

Reliance

11 | Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

Luxembourg law does not place any emphasis on reliance: rather, the general requirements for a prejudice and causation cater for the same legal need.

Causation

12 | Is proof of causation required? How is causation established? How is causation rebutted?

There is no definition of causation that is specific to securities litigation. Under civil law, causation is defined by case law, for both contractual and extra contractual liability. Among various possible concepts of causation, Luxembourg case law mainly operates with the concept of adequate cause: in a chain of events that ended in a prejudice, the prejudice is legally *caused* by the preceding fact that was normally such as to (*normalement de nature à*) cause this prejudice, unlike other preceding facts that only led to the prejudice as a result of exceptional circumstances. Another concept sometimes used by Luxembourg courts is the equivalence of conditions: in this conception of causation, a prejudice is legally *caused* by all the facts that led to it, hence each fact without which the prejudice would not have occurred is a legal cause. This last concept is of a lesser relevance for securities litigation. It is also worth mentioning that under contractual liability, only the prejudice that was foreseeable can be compensated.

Other elements of claim

13 | What elements or defences present special issues in the securities litigation context?

There are no specific elements in this respect.

Limitation period

14 | What is the relevant period of limitation or repose? When does it begin to run? Can it be extended or shortened?

In commercial matters, the statute of limitation provided by article 189 of the Luxembourg Commercial Code is 10 years. The limitation period for a contractual liability action only runs from the time when the damage or loss is realised, or from the date on which it was revealed to the victim if the victim establishes that he or she had not previously had knowledge of it. One important exception to this is that under article 2277 of the Luxembourg Civil Code, actions for the payment of interest under a loan (read here: under debt securities) are subject to a limitation of five years only.

There is no specific rule that applies to securities litigation. In practice, securitisation vehicles sometimes provide for limited recourse under their securities to become applicable only after a certain delay (eg, one year).

As a principle, the parties cannot extend the legal statute of limitation delays.

REMEDIES, PLEADING AND EVIDENCE

Remedies

15 | What remedies are available? Do any defences present special issues in the context of securities litigation? What is the measure of damages and how are damages proven?

Luxembourg civil liability legal principles, as supplemented by case law, provide for integral compensation of damages, as this is the principle under the Luxembourg Civil Code. Compensation can be ordered for losses but also for prejudice such as unmade profit and loss of opportunity. The liability of directors or managers of Luxembourg entities is difficult to obtain. In addition to private enforcement for compensation, there is a public enforcement of disclosure rules (Prospectus Law or Transparency Law) by the Financial Sector Supervisory Commission (CSSF), which can also lead to sanctions on the management. Also, the removal of managers or directors is not a sanction provided by

Luxembourg law in relation to investor compensation. However, as the management of a regulated entity is appointed subject to its suitability assessment by the CSSF, their liability can have the consequence that the managers of a regulated issuer or market payer (eg, a financial services provider) will be dismissed from office.

Pleading requirements

16 | What is required to plead the claim adequately and proceed past the initial pleading?

There are no such principles or requirements under Luxembourg law.

Procedural defence mechanisms

17 | What are the procedural mechanisms available to defendants to defeat, dispose of or narrow claims at an early stage of proceedings? What requirements must be satisfied to obtain each form of pretrial resolution?

There are no pre-trial resolutions under Luxembourg civil procedure, except for:

- summary procedures;
- requests for junction of related cases;
- the appointment of an expert by the court; and
- the possibility for a party to raise a defect in the writ or initiation of the claim *in limine litis*.

Parties always have the possibility to reach a settlement between them and to terminate the judicial procedure, in principle at any stage before the pleadings.

Evidence

18 | How is evidence collected and submitted to the court to support securities claims and defences in your jurisdiction? What rules and common practices apply to the introduction of expert evidence and how receptive are courts to such evidence?

There is no disclosure period in the Luxembourg trial procedure before the commercial court. The plaintiff must provide the evidence supporting his or her claims and the defendant is responsible for bringing the evidence supporting his or her counter arguments. These are the ordinary principles of evidence under the Luxembourg Civil Code, consistent with the adversarial nature of Luxembourg commercial trials.

There exist several procedural means for a party to try and obtain evidence from the other party. Before a trial, this will be by way of summary proceeding. A summary proceeding can be initiated before the initiation of a substantial procedure under article 350 of the Luxembourg New Civil Procedure Code, which provides that if there is a legitimate reason to preserve or establish before any trial evidence of facts on which the solution of a dispute may depend, the legally admissible investigative measures may be ordered.

During the trial, under articles 348 and 359 of the Luxembourg New Civil Procedure Code investigative measures may be ordered in any event, if the court does not have sufficient evidence to rule. The facts on which the solution of a dispute depends may, at the request of the parties or ex officio, be the subject of any legally admissible investigative measure.

However, in both cases, an investigative measure may not be ordered to make up for the party's failure to provide evidence.

Further, there is no specific legal framework applying to securities litigation in this respect. In practice, when subscribing debt securities or asset-backed securities, investors will be well advised to look into the information rights that they have under the Luxembourg Company Law and under the terms and conditions of the securities subscribed.

LIABILITY

Primary liability

19 | Who may be primarily liable for securities law violations in your jurisdiction?

Where it comes to private litigation aiming at compensation, there is in principle no limitation to the persons from whom an investor may claim compensation for the consequences of its faults, either under a contract or tort. It is worth noting that here the Prospectus Law provides for the liability of various persons, although it does not set specific principles for the assessment of their liability.

Secondary liability

20 | Are the principles of secondary, vicarious or 'controlling person' liability recognised in your jurisdiction?

A general vicarious liability principle exists under Luxembourg civil law as under article 1384 of the Civil Code. It is based on the concept of a person for whom one is accountable.

Claims against directors

21 | What are the special issues in your jurisdiction with respect to securities claims against directors?

There is a specific framework, under Luxembourg law, for the liability of company directors or managers towards third parties, or towards shareholders. However, company directors or managers will only be liable personally towards third parties in the case of a specific legal breach or of a fault that is separate from their functions.

Claims against underwriters

22 | What are the special issues in your jurisdiction with respect to securities claims against underwriters?

There is no specific principle for liability of underwriters. Their liability may arise, as for any person intervening in the issuance or marketing process, as extra-contractual liability (tort), or under the obligations and undertakings that they subscribed by contract.

Claims against auditors

23 | What are the special issues in your jurisdiction with respect to securities claims against auditors?

Auditors will be liable along the regimes of article 443-2 of the 1915 law on commercial companies or civil liability – with the same result. Being only bound by a best efforts duty, their fault is generally based on the standard of professional scepticism that they should display. Their liability towards third parties or shareholders can also be raised more easily in the case of breach of company law, articles of association, or of the professional rules applying to their profession. Though, their liability to a shareholder will only appear if such shareholder can prove a prejudice that is separate and above the pro rata prejudice suffered through the company via the shares.

COLLECTIVE PROCEEDINGS

Availability

24 | In what circumstances does your jurisdiction allow collective proceedings?

Collective actions or 'class actions' are not possible under applicable Luxembourg law. However, a bill was introduced before the Luxembourg

parliament on 14 August 2020, which purports to introduce into Luxembourg law a framework for collective actions by consumers. This bill has been in discussion since then. Under this bill, consumers could group their action against a professional, asking for the cessation of an unlawful course of action, or compensation for the prejudice that this course of action caused to them. It would be possible where the consumers are in a similar or identical situation and the unlawfulness undermines their individual interests. Among the notable exclusions, a collective action would only be possible in case of breach of contract or of a legal obligation, while competition law breaches would not be covered. Also, no collective action would be possible against professionals who are supervised by the Financial Sector Supervisory Commission (CSSF) or by the Luxembourg insurance authority, which would exclude all financial services providers. These exclusions together with the limited scope of the bill would potentially place some securities litigation outside the scope of collective actions, especially where the securities are listed securities if the action is directed against the issuer itself.

Reliance, causation and damages

25 | Can reliance, causation and damages be determined on a class-wide basis, or must they be assessed individually?

The bill does not contain any provision in this respect but provides first for a first stage (decisions on the admissibility of the claim and on liability) for either an ordinary procedure where the prejudice would be determined 'with regard to the exemplary individual cases' being test cases, or a simplified procedure where the prejudice would be determined globally.

Court involvement and procedure

26 | What is the involvement of the court in collective proceedings and what procedures must be followed to achieve collective treatment of claims? What is the procedure for settling collective proceedings and what is the extent of the court's involvement in settlement?

Under the bill, the relevant court would render a first judgment on the admissibility of the collective claim and would set adequate publicity measures and conditions to adhere to the group of claimants. If the claimants decide not to opt for a settlement procedure, the court would then render a second judgment on the liability and would then open a phase of implementation of this decision by appointing a liquidator, in charge of carrying out the group exclusion or the group inclusion process.

Opt-in/opt-out

27 | In collective proceedings, are claims opt-in or opt-out?

Under the bill, the opt-in (group inclusion) or opt-out (group exclusion) type of procedure would be determined by the court when rendering its second judgment appointing the liquidator. Under the opt-out procedure, all consumers affected by the unlawfulness are by default covered by the compensation unless they opt out; hence it would apply only where all the consumers who suffered the prejudice were known in advance.

Regulator and third-party involvement

28 | What role do regulators, professional bodies and other third parties play in collective proceedings?

Under the bill, the claim can be initiated by an approved association under the Consumer Code, any sector regulating authority (which includes the Financial Sector Supervisory Commission, as listed by the parliamentary works), any non-lucrative association whose objects include interests affected by the unlawfulness, or even any entity so designated by an EU or EEA member state.

FUNDING AND COSTS

Claim funding

29 | What options are available for plaintiffs to obtain funding for their claims? What are the pros and cons of each option, including any ethical issues relating to litigation funding?

There is no framework in Luxembourg for the financing of litigation by third parties; despite the availability in the Luxembourg toolbox of several adapted forms of investment funds, this is not a specially developed class of assets. It is sometimes feasible to restructure the funding of claims via a securitisation vehicle, though rarely and not specifically for securities litigation. Contingency fees exist in Luxembourg for the remuneration of lawyers; they are, however, limited by the Internal Regulations of the Luxembourg Bar: its article 2.4.5.3 prohibits the agreement whereby the remuneration of the lawyer is 'exclusively' based on a success fee, but expressly allows to set a complement of remuneration for the lawyer based on the result of the lawyer's intervention. Contractual reimbursement provisions are not particularly developed in the Luxembourg practice, though legal and enforceable.

Costs

30 | Who is liable to pay costs in securities litigation? How are they calculated? Are there other procedural issues relevant to costs?

There is no specific rule under Luxembourg law for securities litigation. Hence, the ordinary principles of the new Civil Procedure Code will apply. Under article 238 of this code, procedural expenses such as stamps or bailiff costs and expert costs are in principle borne by the losing party, unless the court decides otherwise. In addition, under article 240 of that same code, where it appears unfair to leave a party responsible for the sums incurred by it and not included in the procedure expenses, the court may order the other party to pay the amount it determines. Article 240 is generally used by parties to try and recover at least a portion of their lawyers' fees; notoriously, though, Luxembourg courts are often reluctant to grant substantial amounts in this respect. The parties may also try to claim the reimbursement of their lawyer's fees by inserting it as a part or their prejudice. This is expressly allowed by the case law of the Cour de cassation, but it involves producing to the judge and to the other parties the details of lawyers' invoices.

Plaintiffs do not have to provide security for the cost of defending claims, except that under article 257 of the new Civil Procedure Code, the defendant can ask for it where the plaintiff is a foreign person (with the exceptions of plaintiffs from EU member states or from states having a convention with Luxembourg).

Privilege

31 | What types of legal privilege exist between litigation funders and litigants?

There is no such privilege.

INVESTMENT FUNDS AND STRUCTURED FINANCE

Interests in investment funds

32 Are there special issues in your jurisdiction with respect to interests in investment funds? What claims are available to investors in a fund against the fund and its directors, and against an investment manager or adviser?

The main types of funds are Undertakings for the Collective Investment in Transferable Securities (UCITS) and regulated or unregulated alternative investment funds (AIFs). AIFs can take most company forms: private or public limited liability company, partnership limited by shares or special partnership. Their alternative investment fund manager (AIFM) or UCITS management company distributes or markets the shares (or as applicable the limited partnership interests or units) of the funds to different types of investors. The claims available to investors against the fund or its directors are generally governed by the Luxembourg law dated 10 August 1915 on commercial companies. If an AIFM is appointed by the fund, the AIFM is responsible for the fund and its investors for the performance of its functions based on the AIFM law and cannot discharge itself from the liability even in the case of delegation of functions.

Structured finance vehicles

33 Are there special issues in your country in the structured finance context?

In Luxembourg, the most currently used structured finance vehicles are securitisation vehicles. Pursuant to the applicable law of 22 March 2004 on securitisation, they may be set up in the form of a company (in practice, mainly public and private limited companies) or of a fund managed by a management company. Securitisation funds do not have legal personality; they can be organised as a co-ownership or on the basis of a trust relationship. Securitisation vehicles (regulated or non-regulated) can issue either debt or equity securities that yield or financial profile that reflects the risk of underlying assets. In practice, debt securities are generally preferred because the issue of equity securities by securitisation entities generally require an analysis to avoid any risk of application of the AIF regime, mainly for securitisation funds. The main asset classes are loan receivables, generally not originated by the securitisation company, and fund units. The main characteristic of these vehicles, which is of particular relevance for securities litigation, is that they can limit their exposure through limited recourse and non-petition clauses. Such provisions, whose validity is expressly provided for in the 2004 Securitisation Law, make them insolvency-remote in the case of a shortfall.

CROSS-BORDER ISSUES

Foreign claimants and securities

34 What are the requirements for foreign residents or for holders of securities purchased in other jurisdictions to bring a successful claim in your jurisdiction?

There are no limits to the possibility for a foreign entity or person to lodge a claim with a Luxembourg court, provided the court is competent. As a principle, the circumstance that securities were purchased abroad should not have any impact thereon, provided that the securities or the issuer are governed by Luxembourg law. Luxembourg law does not have any extraterritorial application.

It is relevant here, however, to note that article 470-20 of the Luxembourg 1915 Companies Law allows Luxembourg companies to submit their debt securities to a foreign law, and validates that foreign entities submit their debt securities to Luxembourg law, opting in or opting out of the holders' representation principles under the 1915 Companies Law.

Foreign defendants and issuers

35 What are the requirements for investors to bring a successful claim in your jurisdiction against foreign defendants or issuers of securities traded on a foreign exchange?

The jurisdiction of Luxembourg courts and, as the case may be, the choice of Luxembourg law, are sufficient factors. The circumstance that the securities are listed abroad will not have any impact on, nor add further conditions to, the competence of Luxembourg courts or the capacity for investors to initiate claims before Luxembourg court. The capacity for a foreign issuer to validly submit its securities to the jurisdiction of Luxembourg courts and to Luxembourg law is, however, a question to be assessed under the law applicable to the issuer itself.

Multiple cross-border claims

36 How do courts in your jurisdiction deal with multiple securities claims in different jurisdictions?

In Luxembourg, there is no specific regime in that respect. The ordinary principles of civil procedure would apply: the Luxembourg Civil Procedure Code provides for three express legal cases of suspension of decision-making. In addition, Luxembourg case law has developed a right for courts to decide to suspend their decision-making even outside the three express legal cases (on a case-by-case, in concreto assessment). Finally, though this is not a question of Luxembourg internal law, the taking of concurrent proceedings in more than one jurisdiction in which the Brussels Regulation or the Lugano Convention is applicable, may be precluded by these regimes.

Enforcement of foreign judgments

37 What are the requirements in your jurisdiction to enforce foreign court judgments relating to securities transactions?

The requirements are the same as for any other foreign decision, while a distinction needs to be made on the basis of the relevant forum. A judgment entered by an EU member state court or a European Free Trade Association member state court would be enforced by the Luxembourg courts in accordance with applicable enforcement proceedings as provided for respectively in Regulation (EU) No. 1215/2012 (the Brussels Regulation) or in the convention on jurisdiction signed in Lugano on 30 October 2007 (the Lugano Convention) without a retrial or re-examination, save for the examination of the compliance with Luxembourg public order. A judgment obtained in the courts of another state would be subject to the applicable exequatur procedure as set out in article 678 of the Luxembourg New Civil Procedure Code.

ALTERNATIVE DISPUTE RESOLUTION

Options, advantages and disadvantages

38 What alternatives to litigation are available in your jurisdiction to redress losses on securities transactions? What are the advantages and disadvantages of arbitration as compared with litigation in your jurisdiction in securities disputes?

In Luxembourg, the main alternative to litigation is arbitration. The applicable provisions, which apply to both international and national cases submitted to arbitration, are provided in article 1224 et seq of the Luxembourg New Civil Procedure Code. In addition to these rules, the Chamber of Commerce of the Grand-Duchy of Luxembourg has its own

arbitration centre, with its own arbitration rules. In a publicly expressed and supported effort to increase the importance of Luxembourg as an arbitration centre, a bill was introduced before the Luxembourg parliament on 15 September 2020. While this very important project is built partly on French law, it would maintain the Luxembourg option for a single regime applicable to national and international arbitration. In the current applicable law, the main disadvantage with respect to arbitration is the rule of article 1243 of the Luxembourg New Civil Procedure Code, under which arbitral awards are in no case opposable to third parties.

UPDATE AND TRENDS

Key developments of the past year

39 What are the most significant recent legal developments in securities litigation in your jurisdiction? What are the current issues of note and trends relating to securities litigation in your jurisdiction? What issues do you foresee arising in the next few years?

From a legal standpoint, the main recent legal developments are the draft bills on collective or class actions and the draft bill on arbitration. In a separate area, it is certainly worth noting that as of 1 January 2020, the Luxembourg Stock Exchange completely re-enacted its Rules and Regulations, which contain important principles as to the prospectuses to be prepared for listing on the non-regulated market held by this stock exchange, with a view to align the structure of the documentation on a 'building blocks' approach. Also, in a groundbreaking move, the Luxembourg parliament voted in a law of 1 March 2019 amending the law on the circulation of securities, and which allows the use of blockchain in the issuance and circulation of securities. Even further, the Luxembourg parliament voted a law of 21 January 2021, allowing *dematerialised* securities to also be made via blockchain and the issue account held with a central account keeper can be held, and registrations made therein, within or by means of secured electronic recording devices, including distributed electronic registers or databases.

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GENERAL FRAMEWORK

General climate

1 | Describe the nature and extent of securities litigation in your jurisdiction.

In the Netherlands, securities litigation usually pertains to civil disputes between investors and issuers or vendors of securities. These proceedings occur frequently in the Netherlands and often involve non-Dutch parties. This is because:

- the cost of litigation in the Netherlands is significantly lower than in other jurisdictions, especially common law jurisdictions;
- parties have the opportunity to conduct the entire course of proceedings in English before the Netherlands Commercial Court;
- Dutch courts are relatively lenient in assuming international jurisdiction; and
- Dutch law provides for a class action and class settlement procedure – with the latter procedure giving parties to an out-of-court settlement the option to petition the court to declare their settlement generally binding on each party that falls within the scope of the settlement agreement, which could also include parties that are domiciled in the United States or the Cayman Islands (erga omnes).

Securities litigation in the Netherlands can also involve administrative proceedings between the financial supervisory authorities and supervised entities on, for example, disclosure of inside information.

Courts and time frames

2 | What experience do the courts in your jurisdiction have with securities litigation? Are there specialist courts for securities disputes? What is the typical time frame for securities litigation in your jurisdiction?

In administrative disputes between a financial supervisory authority (ie, the Dutch Authority for the Financial Markets or the Dutch Central Bank) and, for example, the issuer of securities, the district court of Rotterdam is the competent court in the first instance. The Trade and Industry Appeals Tribunal is the competent court in the second instance.

Regarding civil disputes, there is no formally designated specialist court that deals with all securities disputes in the Netherlands. Nonetheless, Dutch courts are experienced in securities litigation, especially the Amsterdam District Court. Aside from regular courts, the Financial Services Complaints Institute, which is an independent dispute committee, deals with disputes between small and medium enterprises (or consumers) and financial institutions (eg, banks, insurance companies, etc) pertaining to financial products and financial services.

As to time frames, more often than not, securities litigation in the Netherlands pertains to complex and international disputes in which a collective claimant initiates class action proceedings against multiple defendants (often Dutch and non-Dutch) for the benefit of a large class (often consisting of Dutch and non-Dutch members). The duration of these proceedings depends on how the court stages proceedings (eg, international jurisdiction, admissibility, applicable law, merits), whether each stage will have an oral hearing, and whether the court will allow for interim appeals (the latter is usually denied, however). Typically, on average, international securities disputes that are litigated in class action proceedings will take around five years to complete in the first instance.

Government regulation and enforcement

3 | What is the relationship between private securities litigation and government regulation and enforcement in your jurisdiction?

Private securities litigation and government regulation and enforcement overlap in the Netherlands, but have different aims.

Government regulation and enforcement mostly apply to listed companies and pertain to, among other things, financial reporting, prospectuses, public offerings, transparency requirements and market abuse. The rules are derived from or contained in, among other things:

- the Transparency Directive (EU Directive 2007/14/EC);
- the Prospectus Regulation (EU Regulation 2017/1129/EU);
- the Takeover Bids Directive (EU Directive 2004/25/EC); and
- the Market Abuse Regulation (EU Regulation 596/2014/EU).

Accordingly, government regulation and enforcement aim to ensure the orderly functioning, integrity and stability of the financial markets and a high level of protection for investors.

Private securities litigation is the body of civil instruments to obtain relief in cases of, for example, breach of contract or tort (eg, in the event of a breach of a statutory duty). Such relief is often ultimately aimed at obtaining monetary compensation.

CLAIMS AND DEFENCES

Available claims

4 | What types of securities claim are available to investors?

Claims can be brought under the Dutch Civil Code (DCC).

Investors can claim damages and, in addition, if they qualify as a consumer, seek a nullification of the purchase agreement of the securities (article 6:193j(3), DCC).

In cases of misrepresentations or omissions of information that aim to promote an investment decision (eg, a prospectus), professional investors can base their claims for damages on the statutory rules on misleading advertising (article 6:194, DCC) and consumers can base their claims for damages or nullification on the statutory rules on unfair commercial practices (article 6:193b, DCC).

Secondary market purchases may create liability for, for example, incorrect investment advice or breach of best execution duties. This will usually lead to claims for damages against advisers or brokers.

Disclosures that commonly give rise to private claims are disclosures in situations where the company is in financial distress or disclosures, either made by the company or by a financial supervisory authority regarding, for example, fraud committed by the company. Some products have led to more disputes than others. For instance, interest swap agreements have been subject to many proceedings about whether the agreement was entered into under the influence of error given the bank's failure to disclose all relevant information (eg, Dutch Supreme Court 4 October 2019, ECLI:NL:HR:2019:1500).

Offerings versus secondary-market purchases

5 | How do claims (or defences to claims) arising out of securities offerings differ from those based on secondary-market purchases of securities?

The context of the dispute and the parties involved are usually different.

A claim resulting out of a securities offering will usually be based on a misleading prospectus and will be made against the issuer or other parties that were involved in the offering (eg, the underwriters). Certain rules regarding the burden of proof in cases of prospectus liability have developed in Dutch case law. For example, in *WorldOnline* (Dutch Supreme Court 27 November 2009, ECLI:NL:HR:2009:BH2162) the Supreme Court ruled that if the prospectus is misleading, it is presumed that investors relied on the misleading prospectus when they decided to invest. Claims based on a misleading prospectus are not limited to investors that bought their shares directly from the issuer, but can also be made by investors that bought their securities on the secondary market.

Claims arising out of secondary market purchases are not usually directed against the issuer or the seller of the securities, but against an adviser or broker that was involved in the secondary market purchase. As to those types of claims, the Supreme Court held in *Van Lanschot* (Dutch Supreme Court 9 February 2013, ECLI:NL:HR:2013:BX7846) that if an adviser violates its obligation to warn for specific risks, the (rebuttable) presumption applies that a causal connection exists between, on the one hand, the adviser's failure to warn and, on the other hand, the investor's damages.

Public versus private securities

6 | Are there differences in the claims or defences available for publicly traded securities and for privately issued securities?

There are certain statutory rules applicable to issuers of publicly traded securities (eg, the Market Abuse Regulation). These rules aim to protect investors against omissions or misleading statements by the issuer. These rules are not applicable to issuers of privately issued securities. The context in which the issuers operate is thus very different and so are the available claims and defences in the case of disputes about the issued securities.

Investors in publicly traded securities can base their claims on breaches of disclosure obligations. By contrast, investors in privately issued securities usually cannot rely on breach of disclosure obligations, since no disclosure obligations for privately issued securities exist, except for the obligation to publish annual accounts. There are no differences in the claims or defences available to very large and smaller parties.

Primary elements of claim

7 | What are the elements of the main types of securities claim?

The main types of securities claims are claims for damages caused by misleading information (eg, prospectus liability) or mis-selling (eg, the security that was sold is not aligned with the risk appetite of the client).

Under article 6:162 and article 6:74 of the DCC, for any claim for damages a claimant must state that:

- the information the claimant was provided with was incorrect or incomplete;
- the provision of the incorrect information can be attributed to the defendant (ie, the defendant knew or ought to have known about the incorrectness or incompleteness of the information);
- the claimant suffered damage;
- such damage was caused by the information provided by the defendant; and
- the relativity requirement is met (ie, the provision that was allegedly violated is designed to protect the claimant from suffering the damage it did).

These elements have to be included in any claim for damages, irrespective of whether the damage was caused by misleading information or mis-selling. However, in the case of prospectus liability certain specific rules apply, among other things with respect to the burden of proof of causation.

Primary defences

8 | What are the most commonly asserted defences? Which are typically successful?

For any type of securities claim, the most commonly asserted defences are:

- that the information or advice provided was correct;
- that the alleged incorrectness of the information or advice cannot be attributed to the defendant;
- causal defences; and
- defences related to the absence of damage.

Which defence is successful strongly depends on the facts and circumstances of a case.

Regarding prospectus liability, the defendant might have difficulties in refuting causality. In *WorldOnline*, the Supreme Court held that in the event of misrepresentations or misleading omissions, the causal relationship between the misrepresentation or misleading omission and the investment decision of a claimant is presumed to exist. However, the defendant can still argue that in its specific case the causal relationship is absent, by showing that the claimant did not rely, directly or indirectly, on the misleading prospectus at the time of purchase. Since this requires information pertaining to the claimant, it is very difficult for defendants to refute this assumption.

Materiality

9 | What is the standard for determining whether the misstated or omitted information is of sufficient importance to be actionable?

For claims based on misleading advertisement or unfair commercial practices, in *WorldOnline* the Dutch Supreme Court gave rules for determining whether the misstated or omitted information is of sufficient importance to be actionable.

The Supreme Court ruled that not every omission or misrepresentation is of sufficient importance. An omission or misrepresentation is of sufficient importance if it can be reasonably assumed that the omission

or misrepresentation, considering the whole context, would have a material impact on the investment decision of an average investor. An 'average investor' is one that is reasonably well informed and reasonably observant and circumspect. These investors are expected to absorb the information provided but are not expected to possess specialist knowledge. This definition is derived from the judgment of the European Court of Justice in *Gut Springenheide* (European Court of Justice 16 July 1998, Case C-210/96).

For claims on the basis of mis-selling, no specific rules apply as to the standard for determining whether advice is sufficiently incorrect to be actionable. What is relevant is whether the claimant based its investment decision on the advice and whether the investment decision would have been different had the advice been correct.

Scienter

10 | What is the standard for determining whether a defendant has a culpable state of mind to support liability? What types of allegation or evidence are typically advanced to support or defeat state-of-mind requirements?

A party responsible for a misrepresentation or for mis-selling is only liable if it knew or ought to have known about the misrepresentation or mis-selling. Intent is not required (article 6:162(3), DCC). Strict liability is not applicable to misrepresentations or mis-selling.

A claim that the defendant knew or ought to have known about the misrepresentation or mis-selling is typically substantiated by either internal documents from the defendant or contemporaneous external sources (eg, analyst reports or expert reports about the situation at the time). The defendant will typically take the position that the substantiation by the claimant is based on hindsight bias and that the facts at the time where ambiguous.

Reliance

11 | Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

Whether proof of reliance is required for claims for misstated or omitted information depends on how a claimant has formulated its claim. Claimants can either take the position that without the misleading information they would not have purchased the securities at all or that they would have bought the securities at a different (lower) price.

In *WorldOnline*, the Dutch Supreme Court gave rules on, among other things, the proof of reliance in cases where investors take the position they would not have bought the securities at all. The Supreme Court held that to provide effective legal protection for investors in cases of misleading information, it is presumed that an investor relied on the incorrect statements or omissions if they were part of the prospectus. This presumption is subject to evidence to the contrary. Reliance can also be indirect. For example, if the investors did not read the misleading information, but relied on investment advice or sentiments on the market that were based on the misleading information.

As to claims based on mis-selling, no specific rules regarding proof of reliance exist. As a result, it is up to the investor to demonstrate that it relied on, for example, the incorrect advice.

Causation

12 | Is proof of causation required? How is causation established? How is causation rebutted?

For any securities claim claimants must prove that the misleading information or mis-selling caused damage. Dutch law requires both 'cause-in-fact' causation and proximate causation. Cause-in-fact causation requires that a 'but for' test is adopted. Proximate causation requires that the damage can be reasonably attributed to the misleading information or advice. Causation requirements, for example, hold that drops in share prices unrelated to the misleading information or omission are not eligible for compensation.

For claims based on prospectus liability, the Supreme Court held in *WorldOnline* that to provide effective legal protection for investors in cases of misleading information, as a general rule, it is presumed that an investor relied on the incorrect statements or omissions if they were part of the prospectus. Although the defendant has the opportunity to rebut this presumption, it does make it more difficult for the defendant to succesfully raise a causation defence.

A similar presumption applies to claims pertaining to the secondary market. As to those claims, the Supreme Court held in *Van Lanschot* that if an adviser violates its obligation to warn for specific risks, the (rebuttable) presumption applies that a causal connection exists between, on the one hand, the adviser's failure to warn and, on the other hand, the investor's damages.

Other elements of claim

13 | What elements or defences present special issues in the securities litigation context?

Aside from the elements mentioned previously, no other elements or defences present special issues in the context of securities litigation in the Netherlands.

Limitation period

14 | What is the relevant period of limitation or repose? When does it begin to run? Can it be extended or shortened?

A claim for damages is typically subject to a limitation period of five years (article 3:310, DCC). This period will commence once the claimant knows that it suffered damage and knows which party is liable for it. This is a subjective criterion, therefore actual knowledge is required. The period of limitation can be interrupted by among other things a written notice. It cannot be extended or shortened. However, other statutory rules, such as the obligation to complain about a fault with convenient speed, could bar a claim for damages even if the limitation period has not expired yet (article 6:89, DCC).

REMEDIES, PLEADING AND EVIDENCE

Remedies

15 | What remedies are available? Do any defences present special issues in the context of securities litigation? What is the measure of damages and how are damages proven?

For each type of claim, investors can claim damages. These are calculated on the basis of a comparison between the actual situation and a hypothetical situation in which the damage-causing act did not occur, which will often be equal to the difference between the actual purchase price and the hypothetical purchase price in the event that the information was complete and correct. Under Dutch law, a claimant cannot make a claim for punitive damages. As a general rule, the burden of proof is on the plaintiff to prove its damages.

Consumers can also seek nullification of the contract (article 6:193j(3), Dutch Civil Code (DCC)).

The main defences relate to causality (ie, asserting that the incorrect or missing information was not the cause for the investment decision or not the cause of the damage).

Pleading requirements

16 What is required to plead the claim adequately and proceed past the initial pleading?

Dutch law does not have special rules for pleading a claim adequately or to proceed past the initial pleading, other than that a claimant must substantiate all elements of the claim in the writ of summons.

If requested by the parties, or ex officio decided by the court, proceedings can commence with a case management hearing, during which parties can express their view on the further course of the proceedings (eg, staging, timetables, etc). This technique is often applied in more complex, international disputes. For instance, the court can decide that parties will first debate international jurisdiction, followed by admissibility, then (if the court assumes jurisdiction and renders the claimant admissible) the applicable substantive law, after which the case moves on to the merits stage.

In class action proceedings initiated on the basis of article 3:305a of the DCC, a staged approach is mandatory (article 1018c(3) and (5), Dutch Civil Code Procedures (DCCP)), which entails that before handling the substantive aspects of the class action claim, the court must, for example, first decide on the claimant's admissibility, which includes assessing whether class action proceedings are more efficient than individual proceedings.

No special rules in this respect apply to securities litigation. There are no provincial or local securities laws within the Dutch legal system.

Procedural defence mechanisms

17 What are the procedural mechanisms available to defendants to defeat, dispose of or narrow claims at an early stage of proceedings? What requirements must be satisfied to obtain each form of pretrial resolution?

Dutch procedural law does not provide for a preliminary review of the merits of the claim or some other form of pre-trial resolution. However, in larger, more complex proceedings, it is not uncommon that parties (and the court) agree to stage the proceedings for efficiency reasons (eg, a jurisdiction phase first, followed by an admissibility phase and, finally, a merits phase (if any)). The court renders a separate judgment for each stage. This can result in the dismissal of the proceedings at an earlier stage (eg, if the court considers it has no jurisdiction or holds the claimant inadmissible in its claims).

Evidence

18 How is evidence collected and submitted to the court to support securities claims and defences in your jurisdiction? What rules and common practices apply to the introduction of expert evidence and how receptive are courts to such evidence?

In general, there are various ways to collect evidence under Dutch law. For example, a claimant can initiate disclosure proceedings on the basis of article 843a of the DCCP, in which it seeks an order from the court that the defendant must disclose certain written documents. Disclosure proceedings are typically initiated prior to filing a claim on the merits. Unlike in common law jurisdictions, there is no mandatory disclosure at the start of the proceedings.

Additionally, another often-used method to obtain evidence is by engaging an expert and/or hearing witnesses. Witness hearings take place before a judge and can occur prior to filing a claim on the merits or during the course of the proceedings, after an interim judgment by the court.

Furthermore, initiating civil inquiry proceedings before the Enterprise Chamber can yield valuable information for shareholders in follow-on securities disputes. Also, regulatory findings by the Dutch Authority for the Financial Markets might contain useful information for a claimant to substantiate its claim in (civil) follow-on securities litigation.

As a general principle, the court is free to attach the evidentiary value to the submitted evidence as it deems appropriate. This principle also applies to expert evidence. Generally speaking, Dutch courts are receptive to expert evidence, although the extent of their receptiveness depends on the case at hand (eg, on the relevance and quality of the expert evidence).

As to common practices with regard to expert evidence, it is compulsory to submit any relevant evidence as an exhibit to either the writ of summons (by the claimant) or the statement of defence (by the defendant). If expert evidence becomes available in the course of the proceedings, it is also possible to submit expert evidence to the court after the written round of submissions prior to an oral hearing.

LIABILITY

Primary liability

19 Who may be primarily liable for securities law violations in your jurisdiction?

In civil cases, the issuer is usually responsible for misstated or omitted information. If the information qualifies as a misleading advertisement or an unfair commercial practice, it will be the issuer that qualifies as the publisher of the misleading information or the trader that conducted unfair commercial practices.

For rendering incorrect advice (mis-selling), the adviser is primarily liable. In addition, under certain circumstances the individual that gave the incorrect advice on behalf of a company may also be primarily liable towards the investor. In such a situation, the individual will usually have recourse against the company.

Secondary liability

20 Are the principles of secondary, vicarious or 'controlling person' liability recognised in your jurisdiction?

Dutch law recognises certain principles of secondary liability, most notably directors' liability for faults of a company, and liability of, for example, lead managers and global coordinators, for omissions in a prospectus. Whether secondary actors can be held liable depends on their specific position and all other circumstances of the case.

Claims against directors

21 What are the special issues in your jurisdiction with respect to securities claims against directors?

Typically, the company (ie, the legal entity) qualifies as the publisher of misleading advertisements or as the trader conducting unfair commercial practices. Although directors are not likely to qualify as publishers of misleading advertisements or traders that conduct unfair commercial practices themselves, they can be potentially liable for misleading conduct in their capacity as a director on the basis of the general tort provision (ie, article 6:162, Dutch Civil Code). Pursuant to case law, directors can only be held liable for faults of a legal entity if serious personal blame can be attributed to them. Such personal blame can be made against a director where he or she was (or should have been) aware of the misleading advertisements and the potential disadvantage to investors. Whether such a situation exists must be assessed on the basis of the specific circumstances of the case. In lower court case law, the evidentiary presumptions regarding the causal link between the misleading conduct and the damage incurred, that was developed

in *World Online* for prospectus liability, has been applied to directors' liability as well.

In administrative proceedings, the Dutch financial supervisory authorities (the Dutch Authority for the Financial Markets and the Dutch Central Bank) are entitled to impose a penalty on the directors of a supervised entity and a penalty on the supervised entity itself, if it violated an obligation under Dutch financial law and it is established that, briefly put, the directors were aware of the activities that caused the violation. Unlike in civil liability proceedings, no serious personal blame is required to impose a penalty on a director.

Claims against underwriters

22 | What are the special issues in your jurisdiction with respect to securities claims against underwriters?

Underwriters can be held liable on the same grounds as issuers if they qualify as a publisher of the misleading advertisement or as a trader that conducted the unfair commercial practices. *WorldOnline* shows that lead managers involved in the drafting and distribution of a prospectus might qualify as publishers of the prospectus. In addition, the Supreme Court held in *WorldOnline* that lead managers can be liable for not correcting misleading statements made by the issuer during a press conference that was held in the context of a book-building process.

Claims against auditors

23 | What are the special issues in your jurisdiction with respect to securities claims against auditors?

Vie d'Or shows that auditors can be held liable if they have not acted as a reasonably competent auditor (Dutch Supreme Court 13 October 2006, ECLI:NL:HR:2006:AW2082). This could be the case if annual accounts approved by the auditor contain omissions or incorrect information and the auditor knew or ought to have known about the omission or incorrect information. Whether or not an accountant acted as a reasonably competent auditor depends on the circumstances of the case. The Supreme Court ruled in *Vie d'Or* that the mere fact that annual accounts contain incorrect information does not automatically result in an auditor's liability.

In addition, in legal literature it has been argued that auditors can also qualify as publishers of misleading information or traders that conduct unfair commercial practices. However, we do not deem this very likely. As far as we know, no case law is available on this issue. Should it nonetheless be determined in case law that a claim against an auditor can be based on misleading advertising or unfair commercial practices, the evidentiary presumptions applicable to misleading advertising and unfair commercial practices would apply.

COLLECTIVE PROCEEDINGS

Availability

24 | In what circumstances does your jurisdiction allow collective proceedings?

Collective proceedings in which several parties transfer their claim to one other party (or, alternatively, mandate the latter party to litigate on their behalf), are available to any natural or legal person.

Class action proceedings on the basis of article 3:305a of the Dutch Civil Code (DCC), in which a collective claimant litigates in its own name, but purports to protect the interests of a class, are available to any association or foundation that has full legal personality and that represents the interests of the class in pursuance of its articles of association (a licence nor government approval is required).

Reliance, causation and damages

25 | Can reliance, causation and damages be determined on a class-wide basis, or must they be assessed individually?

If a collective claimant initiates class action proceedings on the basis of article 3:305a of the DCC and makes a monetary claim, reliance, causation and damages will be assessed for each category of class members (damage scheduling), not on an individual basis (article 1018(i)(2), Dutch Code of Civil Procedure (DCCP)).

If the collective claimant initiates regular liability proceedings, but, for example, does so on behalf of other parties on the basis of a mandate or power of attorney (ie, collective proceedings), reliance, causation and damages must be assessed individually for each party the claimant represents.

Court involvement and procedure

26 | What is the involvement of the court in collective proceedings and what procedures must be followed to achieve collective treatment of claims? What is the procedure for settling collective proceedings and what is the extent of the court's involvement in settlement?

In order for a claim to be admissible in a class action proceeding (ie, the claimant is admissible in its class action claims) that is initiated on the basis of article 3:305a of the DCC, the following requirements must be met:

- the collective claimant is a foundation or association with full legal capacity;
- the interests of its class are sufficiently safeguarded;
- the interests of its class are sufficiently similar to be jointly handled;
- the founders and directors of the collective claimant do not, directly or indirectly, have a motive for profit that is being realised through the use of the collective claimant (such a profit motive is absent if the founders and directors only receive market-term compensation for costs and offered services); and
- the claim is sufficiently connected to the Dutch legal sphere (the so-called 'scope rule').

The collective claimant does not have to disclose the identity of individual class members.

If these requirements are met, no certification of the class takes place, but the court will declare the claimant as admissible in its class action claims. Then, depending on how the proceedings are staged, the court will typically assess the merits of the class action claims.

Dutch law does not prescribe what evidence must be a provided by the claimant to be rendered admissible in its claims: any manner of evidence can be used to substantiate that the aforementioned admissibility criteria are met.

As to the court's involvement, the following applies. If damages are being claimed, the court can order each party to submit separate settlement proposals (article 1018i(1), DCCP). Based on these proposals and, if needed, with the assistance of one or more independent experts, the court may subsequently establish a collective 'settlement' in its judgment, should the court hold the defendant liable (article 1018i(2), DCCP).

The court applies damage scheduling in a collective settlement, which means that it identifies specific damage categories and objective factors by which it can establish which damage category applies to which class member.

Alternatively, if the parties reach an out-of-court settlement, they can make a joint request to the court to declare the settlement generally binding on each injured party that falls within the scope of the settlement agreement (article 7:907(1), DCC). The court will assess, among other things, whether the settlement sum in the settlement agreement is fair

(including any fee to be paid to the collective claimant under the settlement) and whether the collective claimant is sufficiently representative of the injured parties it claims to protect (article 7:907(3), DCC).

Opt-in/opt-out

27 | In collective proceedings, are claims opt-in or opt-out?

Under the Dutch class action procedure, an opt-out regime applies to Dutch class members (article 1018f(1), DCCP). An opt-in regime applies to non-Dutch class members (article 1018f(5), DCCP). In other words, non-Dutch class members must opt-in if they wish to be bound by the outcome of the class action proceedings and Dutch class members are automatically bound unless they opt-out.

Regulator and third-party involvement

28 | What role do regulators, professional bodies and other third parties play in collective proceedings?

They play no formal role in civil class action proceedings. However, regulatory findings of, for example, the Dutch Authority for the Financial Markets, can be used to substantiate a claim in civil follow-on litigation.

FUNDING AND COSTS

Claim funding

29 | What options are available for plaintiffs to obtain funding for their claims? What are the pros and cons of each option, including any ethical issues relating to litigation funding?

Claimants have several options for claim funding, such as litigation insurance and third-party litigation funding.

Third-party litigation funding is allowed under Dutch law and is relatively unrestricted. However, certain rules do apply to class actions (eg, the claimant must ensure that it has sufficient control over its claim (article 3:305a(2)(c), Dutch Civil Code)).

Several local and international third-party funders are active in the Netherlands. An evident benefit of third-party litigation funding is that disputed claims often require costly, lengthy and risky proceedings to fund, and third-party litigation funding shifts those risks and expenses to the financer. However, depending on the structure of the funding agreement, control of the suit and instruction of counsel can also shift to the financer.

Other ways for plaintiffs to fund litigation are membership fees or through using a percentage of the proceeds. Such arrangements are commonly used by collective claimants. This is admissible if such claimants do not have a profit motive (ie, they should entail compensation on market terms for costs and offered services).

Contingency fees are not allowed under Dutch law (article 7.7, Legal Profession Bye-law). Some alternative fee arrangements, such as 'no-cure, less fee' or a combination of a basic fee and a success fee, are allowed, provided that the arrangement is reasonable (see District Court Rotterdam 28 March 2018, ECLI:NL:RBROT:2018:2803).

Costs

30 | Who is liable to pay costs in securities litigation? How are they calculated? Are there other procedural issues relevant to costs?

Dutch law provides for a loser-pays system in which the losing party is obligated to pay the legal fees, such as attorney and court fees. However, the fees to be disbursed are calculated using a fixed table for liquidated costs and will generally amount to only a fraction of the actual costs incurred.

Privilege

31 | What types of legal privilege exist between litigation funders and litigants?

Under Dutch law, no legal privilege between litigation funders and litigants exists. Only information exchanged between an attorney and its client can be legally privileged, provided that the attorney received the information in its capacity as attorney (article 11a(1), Act on Advocates). If the attorney is engaged by the funder directly and the funder manages the case, the funder and the counsel will usually enter into an attorney-client relationship. In that case, information exchanged between the funder and the attorney is legally privileged.

INVESTMENT FUNDS AND STRUCTURED FINANCE

Interests in investment funds

32 | Are there special issues in your jurisdiction with respect to interests in investment funds? What claims are available to investors in a fund against the fund and its directors, and against an investment manager or adviser?

In the Netherlands, investment funds are structured as either corporations (with legal personality) or as a fund for joint account (without legal personality). They are regulated under either the European Alternative Investment Fund Managers Directive (Directive 2011/61/EU) or under the Undertakings for Collective Investment in Transferable Securities Directive (Directive 2009/65/EC). If tradeable, participation in these investment funds can be traded in accordance with Dutch property law on the transfer of shares (if the investment fund is a corporation) or in accordance with the investment contract (if the investment fund is not a corporation). Such participations are typically traded through brokers or trading venues.

An investment fund manager is obligated to prepare and share a prospectus that relates to the participation rights in the investment fund. Investors can bring forward claims relating to omissions or misleading information in the prospectus. In addition, investors could file claims against the fund manager for breaches of the terms and conditions of management and custody, or for breaches of statutory obligations as laid down in the Dutch Financial Services Act.

Structured finance vehicles

33 | Are there special issues in your country in the structured finance context?

Dutch law does not contain a national securitisation regime. However, the EU Securitisation Regulation (2017/2402/EU), which entered into force on 1 January 2019, harmonised the rules for securitisations in the EU.

CROSS-BORDER ISSUES

Foreign claimants and securities

34 | What are the requirements for foreign residents or for holders of securities purchased in other jurisdictions to bring a successful claim in your jurisdiction?

No specific requirements apply to the non-Dutch claimant. If, according to the Dutch conflict of law rules, non-Dutch law governs the claim, the Dutch court will have to apply that non-Dutch substantive law, unless this application would be contrary to Dutch public policy (article 10:6, Dutch Civil Code).

Foreign defendants and issuers

35 | What are the requirements for investors to bring a successful claim in your jurisdiction against foreign defendants or issuers of securities traded on a foreign exchange?

In cross-border securities litigation, the Dutch court must assess whether it has jurisdiction to rule on the claims against the foreign defendant pursuant to either an international treaty or convention, the Brussels I Regulation or, if none of these are applicable, Dutch private international law.

Each of these legal systems provides for multiple (alternative) grounds under which a Dutch court can assume jurisdiction over a non-Dutch defendant. For example, if there are multiple defendants and one (or more) of them is domiciled in the Netherlands, the Dutch court can assume jurisdiction over the non-Dutch defendants if the claims against the non-Dutch defendants are so closely connected to the claims against the Dutch defendants that it is expedient to hear and determine them together to avoid the risk or irreconcilable judgments (see article 8(1), Brussels I Regulation).

In addition, a Dutch court has jurisdiction in matters relating to tort if the damaging event occurred in the Netherlands (see article 7(2), Brussels I Regulation). According to established case law of the European Court of Justice (ECJ), this encompasses both the place of the harmful event and the place where the damage manifested itself if they did not occur in the same country. As to the place where the damage manifested itself, the ECJ recently further clarified how to localise financial loss of shareholders in *VEB v BP*. In summary, the ECJ ruled that in light of the foreseeability requirement, the place where the damages occur cannot be equalled to the location of the investor's securities account if the bank of the securities account is domiciled in a jurisdiction in which BP, the issuing company, is not subject to statutory disclosure obligations. As a result, the court of the place in which the investor holds its securities account can only assume jurisdiction if the issuing company has a statutory disclosure obligation in the said jurisdiction.

Furthermore, in the case of a contractual claim, the Dutch court can assume jurisdiction if the Netherlands is the place of performance of the obligation in question (article 7(1), Brussels I Regulation).

Multiple cross-border claims

36 | How do courts in your jurisdiction deal with multiple securities claims in different jurisdictions?

The Brussels I Regulation contains provisions on how courts of European Union member states must handle already pending proceedings in and outside the EU.

If, at the time the suit was brought before the Dutch court, proceedings involving the same parties and the same cause of action were already brought before the courts of a different EU member state, the Dutch court will – on its own motion – have to stay the Dutch proceedings until the jurisdiction of the court first seised is established (article 29(1), Brussels I Regulation). If this happens, the Dutch court must reject jurisdiction in favour of the first court (article 29(3), Brussels I Regulation).

The Brussels I Regulation also contains provisions for related proceedings. These proceedings might have a different cause of action or involve different parties, but, nonetheless, are so closely connected that it is expedient to hear and determine them together to avoid the risk of irreconcilable judgments resulting from separate proceedings (article 30(3), Brussels I Regulation). If the Dutch court is not the court first seised, it may stay the proceedings if related proceedings are conducted in another member state (article 30(1), Brussels I Regulation).

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Enforcement of foreign judgments

37 | What are the requirements in your jurisdiction to enforce foreign court judgments relating to securities transactions?

The enforcement of judgments rendered by a non-Dutch court is, in an EU context, governed by the Brussels I Regulation.

As a general principle, a judgment rendered in a member state that is enforceable in that member state is enforceable in the Netherlands without any declaration of enforceability required (article 39, Brussels I Regulation). Only in exceptional circumstances can enforcement be denied (article 46 in connection with article 45, Brussels I Regulation). This is, for example, the case if recognition of the judgment is manifestly contrary to Dutch public policy.

Judgments rendered by non-EU courts, however, are not enforceable in the Netherlands (article 431, Dutch Code of Civil Procedure (DCCP)), unless enforceability is provided for in a treaty or in Dutch law. If enforceability is not provided for, the claimant will (in principle) have to re-litigate and bring a new suit before the Dutch court, which will fully and independently assess the claim (article 431 lid 2, DCCP). However, in *Gazprombank* the Dutch Supreme Court ruled that Dutch courts will award a claim without a substantive assessment if certain basic criteria as to the fairness of the proceedings have been met (Dutch Supreme Court 26 September 2014, ECLI:NL:HR:2014:2838).

ALTERNATIVE DISPUTE RESOLUTION

Options, advantages and disadvantages

38 | What alternatives to litigation are available in your jurisdiction to redress losses on securities transactions? What are the advantages and disadvantages of arbitration as compared with litigation in your jurisdiction in securities disputes?

Parties can opt for arbitration, binding advice proceedings or mediation. For securities litigation, most financial services providers in the Netherlands are affiliated with the Financial Services Complaints Institute (Kifid), which is an independent dispute agency specialising in dispute resolution between small and medium enterprises (and consumers) and financial institutions (eg, banks, insurance companies, etc). In most cases, the judgment of the Kifid will take the form of binding advice.

The main advantages of arbitration compared to proceedings before state courts are confidentiality and the flexibility to agree on a tailor-made procedure, including the appointment of (more specialised) arbitrators by the parties themselves. On the other hand, arbitration is often more costly than regular litigation and the outcome can be less predictable in practice.

Mediation has the advantages that it is both confidential as well as voluntary and non-committal. Mediation is often less time-consuming and less adversarial, which can help maintain or re-establish a good relationship between parties. Dutch law does not have a statutory legal framework for mediation.

UPDATE AND TRENDS

Key developments of the past year

39 What are the most significant recent legal developments in securities litigation in your jurisdiction? What are the current issues of note and trends relating to securities litigation in your jurisdiction? What issues do you foresee arising in the next few years?

Recent legal developments

The most significant recent legal development in Dutch securities litigation remains the Act on Collective Settlement of Mass Damages Claims (WAMCA), which is a law that entered into force on 1 January 2020. It is having a profound impact on the Dutch class action procedure (which is often used in securities litigation) and applies to all class action proceedings that, briefly put, are initiated on or after 1 January 2020 and pertain to events that took place on or after 15 November 2016. Most notably, the WAMCA enables a collective claimant to make a claim for damages, which, if the claim is awarded, will be binding for Dutch class members who do not opt-out, as well as for non-Dutch class members who opt-in. Furthermore, the WAMCA has introduced more stringent admissibility requirements.

In addition, on 1 January 2019, the Netherlands Commercial Court and the Netherlands Commercial Court of Appeal were established. They are part of the Amsterdam District Court and the Amsterdam Court of Appeal, respectively.

Cases brought before these courts are conducted in English, including the written statements, the oral hearing and the judgment. We foresee that the opportunity to conduct proceedings in the English language, combined with the WAMCA creating the possibility to make a claim for damages in a Dutch class action procedure, will further increase the number of class action proceedings (including securities litigation) held in the Netherlands over the next few years.

Finally, EU Regulation 2019/2088/EU on sustainability- related disclosures in the financial services sector (SFDR) entered into force on 10 March 2021. The SFDR imposes mandatory environmental, social and corporate governance (ESG) disclosure obligations on financial advisers (for instance, investment firms who provide investment advice) and financial market participants (for instance, investment firms who provide portfolio management). They have to be transparent about the integration of sustainability risks in their investment advice or investment decisions. In addition, the SFDR also imposes pre-contractual transparency on adverse sustainability impacts at financial product level (eg, Undertakings for the Collective Investment in Transferable Securities, alternative investment funds, insurance products and portfolios under discretionary and individualised management), especially if the financial product promotes environmental or social characteristics. While there is no case law yet, misstated or omitted ESG information might give rise to (civil) follow-on securities litigation.

USA

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GENERAL FRAMEWORK

General climate

1 | Describe the nature and extent of securities litigation in your jurisdiction.

The US Congress has enacted multiple statutes that govern federal securities claims, which include the following:

- The Securities Act of 1933 (the Securities Act) focuses on public securities offerings and addresses registration requirements, private remedies, and anti-fraud provisions based on disclosure in registration statements and prospectuses.
- The Securities Exchange Act of 1934 (the Exchange Act) governs, among other things, aspects of the public trading of securities, and contains anti-fraud provisions and all public statements and periodic reporting requirements for certain issuers. It also established the Securities and Exchange Commission (SEC), the federal agency that administers and enforces the federal securities laws.
- The Private Securities Litigation Reform Act of 1995 provides for enhanced pleading requirements, a safe harbour for forward-looking statements, and sanctions for abusive litigation.
- The Securities Litigation Uniform Standards Act of 1998 pre-empts many securities fraud class actions that are based on state statutory or common law.
- The Class Action Fairness Act of 2005 extends federal diversity jurisdiction to class actions with 100 or more class members where: (1) the amount in controversy, in the aggregate of all of the class members, exceeds US$5 million; and (2) at least one class member is a citizen of a different state or country from that of any defendant.

In addition, individual US states regulate securities through state statutes, which are commonly known as 'blue-sky' laws. The requirements of blue-sky laws differ substantially from state to state, and may overlap with those of other states and federal law. Most states' blue-sky laws recognise a private right of action for securities fraud. New York's Martin Act, however, restricts enforcement to the state's Attorney General.

After a more than two-decade increase in US securities class-action filings, the number of filings declined for a second consecutive year in 2021, falling 36 per cent over the previous year and reaching the lowest level since 2009. This decrease was driven by a notable decline in new merger-objection class actions, which fell by 85 per cent. As the number of new cases fell, so did the value of settlements. The average settlement decreased in value by over 50 per cent in 2021 to US$21 million, the lowest recorded average in the last 10 years. Despite the overall decline, certain types of filings increased, including claims concerning special purpose acquisition companies – corporations formed for the sole purpose of raising investment capital through initial public offering.

Courts and time frames

2 | What experience do the courts in your jurisdiction have with securities litigation? Are there specialist courts for securities disputes? What is the typical time frame for securities litigation in your jurisdiction?

Most federal securities claims are filed in federal courts, which have exclusive jurisdiction over claims under the Exchange Act. By contrast, claims under the Securities Act may be brought in either federal or state courts. In 2018, in *Cyan, Inc v Beaver County Employees Retirement Fund, 583 US ____ (2018)* the US Supreme Court held that the Securities Litigation Uniform Standards Act does not preclude state courts from exercising jurisdiction over class actions alleging only violations of the Securities Act.

Claims under state blue-sky laws are typically brought in state courts, unless the parties are citizens of different states or the plaintiff asserts other claims over which federal courts have original jurisdiction. Some states, such as New York, have specialised courts that hear complex business matters, which typically include securities claims.

It is rare for US securities claims to survive to trial. From 1997 to 2021, 46 per cent of securities class actions were settled, 43 per cent were dismissed, 0.4 per cent reached trial, and 0.2 per cent were tried to a verdict.

Government regulation and enforcement

3 | What is the relationship between private securities litigation and government regulation and enforcement in your jurisdiction?

Both private and public actors may enforce the US securities laws. Investors may assert claims for violations of the Exchange Act and the Securities Act, typically seeking monetary damages, either individually or as class actions on behalf of large groups of investors. Investors also can seek to enjoin a pending transaction, such as a merger or significant asset divestiture based on allegations that proxy materials soliciting shareholder approval are false or misleading in violation of proxy rules promulgated by the SEC under the Exchange Act. Government regulators, including the SEC, the Commodity Futures Trading Commission, and states' Attorneys General, also may bring civil enforcement actions, often seeking monetary penalties and other sanctions, including in certain circumstances orders barring individuals from serving on public company boards of directors or working in the securities industry. In addition, certain violations of the anti-fraud provisions of the securities laws may expose defendants to criminal liability, including fines and, for individuals, imprisonment.

The SEC, the principal federal agency that enforces the securities laws, adjusts its priorities over time but tends to devote agency resource to actions that maximise policy impact and deterrent effects. The majority of SEC enforcement actions settle, resulting in either

monetary sanctions in the form of disgorgement of profits or fines, or non-monetary sanctions, such as injunctions, suspensions, or bars on trading. Historically, private class actions have tended to be more successful than SEC enforcement actions in achieving restitution for plaintiffs, given the limited resources of SEC to prosecute enforcement actions and statutory caps on civil penalties that may be imposed in such actions.

CLAIMS AND DEFENCES

Available claims

4 | What types of securities claim are available to investors?

The most common federal claim asserted by private plaintiffs is for violation of section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act) and Securities and Exchange Commission (SEC) Rule 10b-5 promulgated thereunder, which make it unlawful to employ deceptive or manipulative devices in connection with the purchase or sale of securities. Section 10(b) claims are often coupled with claims under section 20(a) of the Exchange Act, which imposes joint and several liability on persons who exercise actual power or control over persons found liable under section 10(b). Section 20A of the Exchange Act also permits private plaintiffs to bring claims for insider trading – trading on material non-public information in breach of duty of trust or confidence – where the plaintiff traded 'contemporaneously' with the defendant. Government regulators, however, enforce insider trading – which the US Supreme Court has held violates section 10(b) and Rule 10b-5 – more often than private parties.

Private plaintiffs also often assert claims under the Securities Act of 1933 (the Securities Act) in connection with the public offerings of securities. Common claims are for violation of section 11 of the Securities Act, which prohibits misstatements in registration statements, and section 12(a)(2), which prohibits misstatements in the sale of securities sold via a prospectus (a document describing a public offering of securities) or oral communication.

Each US state also regulates securities through 'blue-sky' laws which often involve analogous causes of action. These laws vary significantly by state.

Offerings versus secondary-market purchases

5 | How do claims (or defences to claims) arising out of securities offerings differ from those based on secondary-market purchases of securities?

The main difference between securities claims arising out of initial offerings versus secondary-market purchases is the element of 'scienter', or a mental state embracing an intent to deceive, manipulate, or defraud. Claims brought under sections 11 and 12(a)(2) of the Securities Act – which prohibit misstatements in a registration statement and other offering communications – do not require proof of scienter.

While scienter is not an element of sections 11 or 12(a)(2) claims, defendants may raise a number of defences not available to section 10(b) defendants in response to those claims. Section 11, for example, exempts from liability persons who undertook reasonable efforts to investigate and verify the statements in the registration statement. Section 12, moreover, does not impose liability on persons who, in the exercise of 'reasonable care', could not have known of the alleged untruth or omission. Sections 11 and 12(a)(2) both apply only to securities traceable to the offering in which allegedly false or misleading statements occurred.

Public versus private securities

6 | Are there differences in the claims or defences available for publicly traded securities and for privately issued securities?

Section 10(b) of the Exchange Act and SEC Rule 10b-5 govern purchases and sales of both privately issued and publicly traded securities. Sections 11 and Section 12(a)(2) of the Securities Act, by contrast, are limited to purchasers who bought stock in a public offering. That is because section 11 prohibits misstatements and omissions in registration statements, which are not required for private placements, and section 12(a)(2) is limited to purchasers who bought stock in an offering pursuant to a 'prospectus' – a document that describes a 'public offering' of securities (*Gustafson v Alloyd Co, Inc*, 513 US 561 (1995)).

Primary elements of claim

7 | What are the elements of the main types of securities claim?

Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder

The elements of the claim are:

- a misstatement or omission of material fact;
- scienter (intent);
- a connection with the purchase or sale of securities;
- reliance;
- economic loss; and
- loss causation.

Section 11 of the Securities Act of 1933

The elements of the claim are:

- the plaintiff purchased a registered security, either directly from the issuer or in the aftermarket if the purchase is traceable to the offering;
- the defendant participated in the offering in a manner sufficient to give rise to liability under section 11; and
- the registration statement contained an untrue statement of material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

Section 12(a)(2) of the Securities Act of 1933

The elements of the claim are:

- the defendant passed title or other interest in the security to the buyer for value, or successfully solicited the purchase of a security;
- the sale was effectuated by means of a prospectus (a document that describes a public offering) or oral communication; and
- the prospectus or oral communication included an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements not misleading.

Primary defences

8 | What are the most commonly asserted defences? Which are typically successful?

Defendants may raise various threshold defences at the outset of a securities action. Common defences include:

- the action is untimely under the applicable statute of limitations or statute of repose;
- the securities transaction was not 'domestic' (ie, it did not occur within the United States or on a US exchange (*Morrison v National Australian Bank, 561 US 247 (2010)*));
- the transaction did not involve a 'security' as defined in the Securities Act;
- for claims under sections 11 or 12(a)(2) of the Securities Act, the plaintiff cannot demonstrate that the securities are traceable to

the offering in which allegedly false or misleading statements were made; and
- a state law claim based on the transaction is pre-empted by federal law under the Securities Litigation Uniform Standards Act.

Section 10(b) defendants also may argue, either on the pleadings or after discovery, that the plaintiffs have not met critical elements of a claim. Defendants frequently argue that there was no misstatement or omission to support a section 10(b) claim (a common defence to section 11 and 12(a)(2) claims as well) and, even if there was, it was not 'material' (ie, a reasonable investor would not view it as significantly altering the total mix of information available). Further, the Private Securities Litigation Reform Act (PSLRA) requires plaintiffs to plead facts that give rise to a strong inference of scienter (intent to deceive), and defendants often challenge plaintiffs' allegations on that basis. Defendants also may contest whether plaintiffs have established 'loss causation' (ie, a causal link between the alleged misconduct and economic harm suffered by the plaintiff).

Defendants may challenge section 11 and 12(a)(2) claims on a variety of grounds, including that:
- the alleged misstatement or omission was not 'material';
- the plaintiff knew of the misstatement or omission at the time of purchase;
- the defendant did not know the registration statement became effective and timely advised the public and the SEC;
- for section 11 claims, the non-issuer defendant undertook reasonable efforts to investigate and verify the statements in the registration statement or resigned before the registration statement becomes effective;
- for section 12(a)(2) claims, the defendant, in the exercise of 'reasonable care', could not have known of the alleged untruth or omission; and
- the plaintiff's loss was not caused by the misstatement or omission (the 'negative causation' defence).

Materiality

9 | What is the standard for determining whether the misstated or omitted information is of sufficient importance to be actionable?

To establish liability under sections 10(b) and sections 11 or 12(a)(2), a plaintiff must not only demonstrate a misstatement or omission, but that it was 'material' within the meaning of the securities laws. Materiality depends on whether a substantial likelihood exists that a reasonable investor would have viewed the misstatement or omission as significantly altering the total mix of information made available (*Basic Inc v Levinson, 485 US 224, 231–32 (1988)*). Generally, materiality is fact-dependent and must be determined case-by-case based on the circumstances. Courts, however, have found certain generic or unverifiable statements to be immaterial as a matter of law, including certain statements of opinion, forward-looking statements coupled with meaningful cautionary language, and 'puffery' (ie, vague or optimistic rhetoric about a company's business or prospects).

Scienter

10 | What is the standard for determining whether a defendant has a culpable state of mind to support liability? What types of allegation or evidence are typically advanced to support or defeat state-of-mind requirements?

Section 10(b) claims require factual allegations, and, ultimately, evidence of scienter (an intent to deceive, manipulate or defraud). The PSLRA further requires that the plaintiffs' complaint, in order to survive a motion to dismiss, allege facts that give rise to a 'strong' inference of scienter, which may be established with allegations that the defendants had both the motive and opportunity to commit fraud, or engaged in conscious misbehaviour or recklessness. Most lower courts have held that extreme recklessness will also suffice, but the US Supreme Court has not yet addressed that question. The scienter of a business entity may be inferred from an individual who acted with scienter and whose scienter can be imputed to the entity, for example, because the individual acted with authority or within the scope of his or her employment. In rare cases, scienter may be inferred from a misstatement so significant that the maker's intent can be assumed.

Proof of state of mind is not required to establish a prima facie claim under sections 11 and 12(a)(2) of the Securities Act. Under section 11, however, non-issuer defendants may avoid liability if, after a reasonable investigation, they had reasonable grounds to believe the statements in the registration were true. Similarly, under section 12(a)(2), liability may not extend to those who, in the exercise of 'reasonable care', could not have known of the alleged untruth or omission.

Reliance

11 | Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

'Reliance', also known as 'transaction causation', requires a plaintiff to plead and prove that but for an alleged misstatement or omission, the investor would not have purchased or sold the security. A plaintiff may satisfy the requirement with evidence that it was aware of an alleged misstatement and acquired the security on that basis. More commonly, however, a plaintiff will seek to utilise one of two presumptions of reliance articulated by the US Supreme Court. Under the 'fraud on the market' theory, reliance is presumed if the security is traded on an 'efficient' market between the date of the misrepresentation and the date of correction (*Basic Inc v Levinson, 485 US 224 (1988)*). This presumption is based on the notion that in an efficient market, the integrity of the stock price reflects all available public information and investors are presumed to rely on the security's price in making a purchase or sale decision. In addition, reliance may be presumed in cases primarily involving omissions, on the theory that reliance is impossible to prove when no positive statements were made (*Affiliated Ute Citizens of Utah v United States, 406 US 128 (1972)*). These presumptions of reliance are especially important in securities class actions, where otherwise individual questions of reliance across a putative class would predominate over common questions, and, in most cases, defeat the class-action mechanism.

Reliance is not an element of a claim under section 11 or 12(a)(2) of the Securities Act. A defendant, however, may defeat these claims upon a showing that plaintiff knew of the falsity of a statement or omitted fact when it purchased the subject securities.

Causation

12 | Is proof of causation required? How is causation established? How is causation rebutted?

In addition to establishing 'transaction causation' (reliance), a section 10(b) plaintiff also must demonstrate 'loss causation' (ie, a causal link between the alleged misconduct and economic harm suffered by the plaintiff) (*Dura Pharmaceuticals, Inc v Broudo, 544 US 336 (2005)*). Expert testimony often is necessary to prove loss causation, including event or econometric studies that seek to eliminate other causes of loss. Most cases establish loss causation through evidence of a 'corrective disclosure' that publicly revealed the falsity of the alleged misstatement or omission, leading to a subsequent decline in value of the security.

Loss causation is not an element of a section 11 or 12(a)(2) claim. A defendant, however, may reduce or eliminate damages under these

claims (and under section 10(b) as well) by proving that depreciation in the value of the security resulted from events other than misrepresentations or omissions.

Other elements of claim

13 | What elements or defences present special issues in the securities litigation context?

Only actual 'purchasers' or 'sellers' of securities, as defined in the Exchange Act, have standing to assert section 10(b) claims. A decision not to engage in a securities transaction (ie, to hold the security) does not suffice. In addition, section 10(b) only imposes liability on individuals who satisfy each element of the claim, not those who may have aided or abetted such individuals (known as secondary violators). In 2019, however, the US Supreme Court called into question the dividing line between primary and secondary violators, holding that section 10(b) is sufficiently broad to include the dissemination of false or misleading information with the intent to defraud, even if the individual did not 'make' (have actual authority over) the statement (*Lorenzo v SEC, 139 S. Ct. 1094 (2019)*).

For section 11 and 12(a)(2) claims, a plaintiff may sue only if it acquires securities issued in the offering in which there was an allegedly false or misleading statement. Where claims are based on an untruth or omission in a registration statement, the plaintiff must show that it acquired its shares pursuant to that registration statement. The impact of this requirement in US direct listings, where both registered and unregistered shares may reach the public at the same time, is currently being considered by US courts (*Pirani v Slack Techs, Inc, 13 F.4th 940 (9th Cir. 2021)*).

Limitation period

14 | What is the relevant period of limitation or repose? When does it begin to run? Can it be extended or shortened?

The statute of limitations is two years for section 10(b) claims and one year for section 11 and 12(a)(2) claims. A statute of limitations begins to run when a plaintiff actually discovered, or a 'reasonably diligent plaintiff' should have discovered, the facts constituting the violation. The limitations period may be extended for individual plaintiffs during the pendency of a class action under the Supreme Court-developed doctrine of '*American Pipe*' tolling. This doctrine provides that, when a putative class action is filed, the running of the statute of limitations is suspended ('tolled') for all members of the proposed class until a decision is made whether to permit the case to proceed on a class-wide basis, or a plaintiff ceases to be a class member.

In contrast to statutes of limitations, statutes of repose represent an 'absolute' bar on a plaintiff's ability to commence litigation, and tolling does not apply (*CalPERS v ANZ Securities, 137 S. Ct. 2042 (2017)*). The applicable statute of repose is five years for section 10(b) claims and three years for section 11 and 12(a)(2) claims. A state of repose runs from the date of the 'last culpable act', regardless of when the plaintiff should have discovered the alleged misstatement or omission.

REMEDIES, PLEADING AND EVIDENCE

Remedies

15 | What remedies are available? Do any defences present special issues in the context of securities litigation? What is the measure of damages and how are damages proven?

For section 10(b) claims under the Securities Exchange Act of 1934, a plaintiff's sole remedy is monetary damages; injunctive or other equitable relief is not available. The amount recoverable is generally measured by 'out of pocket' damages, (ie, the difference between the price paid for a security and the actual (or 'real') value of the security at the time of purchase, absent the misrepresentations). Damages are further limited to loss actually caused by the fraud, not by other factors. The Private Securities Litigation Reform Act also imposes a statutory limit on damages, limiting recovery to the difference between the purchase price and 'the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.' Calculating damages is complex in class actions, with plaintiffs and defendants typically offering experts who opine that the class suffering markedly different damages.

Claims under section 11 of the Securities Act of 1933 (the Securities Act) permit three possible measures of damages, which require comparing the difference between the stock purchase price to:

1 the stock price when the suit was filed;
2 the stock sale price, if sold before suit; or
3 the stock sale price after the suit was filed if less than calculation (1).

Claims under section 12 of the Securities Act permit either rescission (if the security still is owned) or damages (if not), in either case measured as the purchase price, plus interest, less any income received from the security.

A defendant also may avoid liability under sections 11 and 12 by showing that depreciation in the value of the security resulted from causes other than misrepresentations or omissions. A special issue is the case of 'in-and-out traders', who trade a security after a misstatement, but exit the position before the misstatement is corrected. That trader may not have any actionable damages (ie, because he or she bought and sold at the artificially inflated value), which could disqualify the trader from bringing an action or belonging to a class.

Pleading requirements

16 | What is required to plead the claim adequately and proceed past the initial pleading?

The Private Securities Litigation Reform Act (PSLRA) and the Federal Rules of Civil Procedure (FRCP) subject section 10(b) claims to heightened pleading requirements. Under the PLSRA, a plaintiff must plead facts (not conclusory allegations) that give rise to a 'strong' inference of scienter (intent to deceive), such as by identifying a motive and opportunity to defraud or strong circumstantial evidence of conscious misbehaviour or recklessness. Under Rule 9(b) of the FRCP, a plaintiff must plead details of the alleged fraud with particularity (ie, the misstatement, who made the misstatement, when it was made, and why it was fraudulent).

Claims under sections 11 and 12(a)(2) are generally not subject to such heightened pleading requirements. If, however, a section 11 or 12 plaintiff pleads that a claim arises from a fraudulent course of conduct, the plaintiff must plead details of the fraud with particularity in accordance with Rule 9(b).

Procedural defence mechanisms

17 | What are the procedural mechanisms available to defendants to defeat, dispose of or narrow claims at an early stage of proceedings? What requirements must be satisfied to obtain each form of pretrial resolution?

The FRCP offers defendants a number of procedural mechanisms to dispose of or limit the scope of claims during the lifecycle of a securities action, namely:

- a motion to dismiss for failure to state a claim, which challenges whether the pleaded allegations, even if true, meet the legal requirements for liability;

- a motion to strike impertinent or immaterial allegations contained in the pleadings, including, in certain cases, unsupportable class action allegations;
- an opposition to a plaintiff's motion for class certification, which, if successful, can substantially limit the scope of a plaintiff's claims and recoverable damages (and, as a practical matter, often leads to termination of the litigation);
- a motion for summary judgment, which challenges whether one side is entitled to judgment as a matter of law because there are no material issues of disputed fact after the opportunity to conduct discovery and the movant is entitled to judgment as a matter of law on those undisputed facts; and
- if a case survives to trial, a motion for judgment as a matter of law, which asks the court, after a party has been fully heard, to find that a reasonable jury would not have a legally sufficient evidentiary basis to find for the party; a party may renew the motion after trial and, alternatively, ask for a new trial.

Evidence

18 | How is evidence collected and submitted to the court to support securities claims and defences in your jurisdiction? What rules and common practices apply to the introduction of expert evidence and how receptive are courts to such evidence?

In US litigation, parties collect evidence during a period called 'discovery', in which parties can request information in the form of documents and depositions (ie, testimony under oath) from each other and non-parties, subject to court oversight as necessary. The PSLRA requires that discovery be stayed during the pendency of any motion to dismiss, unless the court finds that discovery is necessary to preserve evidence or prevent undue prejudice to a party. It remains unsettled whether the PSLRA discovery stay applies to claims under the Securities Act brought in state court.

Parties commonly hire expert witnesses to offer opinions on complex topics, such as damages, causation, or industry customs. Courts are receptive to such evidence where it will assist the trier of fact, but occupy a 'gatekeeper' function in that they carefully scrutinise the expert's credentials and methods for reliability before admitting such evidence.

LIABILITY

Primary liability

19 | Who may be primarily liable for securities law violations in your jurisdiction?

Only after the trier of fact finds that a plaintiff has satisfied each element and precondition for liability (primary violators), may the defendant be held liable under section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act); the statute does not extend to individuals who only aid or abet violations (*Stonebridge Investment Partners, LLC v Scientific-Atlanta, 552 US 148 (2008)*). In 2019, however, the US Supreme Court called into question the dividing line between primary and secondary violators, holding that section 10(b) is sufficiently broad to include the dissemination of false or misleading information with the intent to defraud, even if the individual did not 'make' (have actual authority over) the statement (*Lorenzo v SEC, 139 S. Ct. 1094 (2019)*).

Plaintiffs may pursue section 11 claims under the Securities Act of 1933 (the Securities Act) against a wide range of participants in drafting a registration statement, including underwriters, experts, auditors, officers and directors of the issuer, and the issuer itself. By contrast, section 12(a)(2) of the Securities Act permits claims only against a 'seller' of securities who makes a misrepresentation orally or through a prospectus (a document that describes a public offering of securities).

Secondary liability

20 | Are the principles of secondary, vicarious or 'controlling person' liability recognised in your jurisdiction?

Section 20(a) of the Exchange Act and section 15 of the Securities Act provide for the liability of 'control persons' (ie, individuals who exercise actual power or control over primary violators of section 10(b) and sections 11 or 12(a)(2), respectively). Courts are split on what must be shown to establish 'control'. Some courts require proof that the control person was a 'culpable participant' in the violation, but others have held that control over the primary violator is sufficient for liability, regardless of whether the control person acted culpably.

A control person can avoid liability if, as to section 10(b), that person acted in good faith and did not induce the violation and, as to sections 11 and 12(a)(2), the person lacked a reasonable basis to know of the facts giving rise to the violation.

Claims against directors

21 | What are the special issues in your jurisdiction with respect to securities claims against directors?

Directors do not face liability under the securities laws simply by virtue of their status as directors of a company that commits a violation; rather, the elements of the specific claim must be satisfied as to each director. It is difficult to hold non-management directors liable under section 10(b) because they rarely act publicly on behalf of the corporation. It also may be difficult to establish that a director had sufficient knowledge of the circumstances surrounding the misstatement to have acted with recklessness or fraudulent intent. By contrast, directors can be liable under section 11 for a misstatement in a registration statement, but may defeat such a claim by proving that they exercised due diligence. Directors rarely face liability under section 12(a)(2), which only reaches actual 'sellers' of securities offered pursuant to a false or misleading prospectus or oral communication.

Directors likewise do not automatically face 'control person' liability for violations committed by a company. Several US courts of appeals require 'culpable participation' in the misconduct for plaintiffs to successfully assert control person liability. This standard is difficult to prove for directors, as plaintiffs must prove a culpable state of mind in addition to actual power or control over the primary violator.

Any defence costs or costs of settlement incurred by a director likely will be reimbursed by a company-provided insurance policy that covers directors and officers or through a right of indemnification from the company.

Claims against underwriters

22 | What are the special issues in your jurisdiction with respect to securities claims against underwriters?

Underwriters can be liable under section 10(b) of the Exchange Act if they meet all elements of the claim (eg, by knowingly making a material misstatement or omission in connection with the sale of a security).

An underwriter may face liability under section 11 of the Securities Act for false or misleading statements contained in a registration statement, but can avoid liability by showing that it acted with due diligence.

Underwriters may also fit the definition of 'sellers' under section 12(a)(2) of the Securities Act. In a firm commitment underwriting, underwriters purchase shares from issuers to sell to investors in an offering. In this form of underwriting, underwriters can be liable as sellers under section 12(a)(2). An underwriter, however, may avoid liability by showing

that it was unaware the statement was false and could not have reasonably uncovered the falsity of the statement.

Claims against auditors

23 | What are the special issues in your jurisdiction with respect to securities claims against auditors?

An auditor can be liable under section 10(b), but generally only for its own statements and not those of the issuer. There is no liability under section 10(b) for those who merely aid and abet the making of a misstatement (*Stonebridge Investment Partners, LLC v Scientific-Atlanta*, 552 US 148 (2008)). Additionally, because of the scienter requirement of section 10(b), an auditor must have acted with extreme recklessness or actual knowledge of fraud, which generally requires proof that the auditor knew of, and ignored, red flags indicating fraud. Evidence that an auditor merely breached applicable accounting principles or performed an audit poorly does not suffice.

Auditors whose statements appear in a registration statement can be liable under section 11, which does not have the scienter requirement of section 10(b). An auditor can avoid section 11 liability by showing it acted with due diligence (eg, by showing that it complied with applicable accounting principles).

COLLECTIVE PROCEEDINGS

Availability

24 | In what circumstances does your jurisdiction allow collective proceedings?

In the United States, most securities lawsuits are brought as putative 'class actions', in which the plaintiff seeks to represent the interests of a larger group of similarly situated investors. To proceed as a class action, the plaintiff must show – and the court must find – that the proposed class satisfies the four threshold requirements of Rule 23(a) of the Federal Rules of Civil Procedure (FRCP), namely:

- numerosity (the class is so numerous that joinder of all members is impracticable);
- commonality (there are questions of law or fact common to the class);
- typicality (the claims or defences of the representative parties are typical of the claims or defences of the class); and
- adequacy of representation (the representative parties will fairly and adequately protect the interests of the class).

In addition, the proposed class must satisfy the requirements of Rule 23(b) of the FRCP. In most securities cases, plaintiffs attempt to do so by demonstrating that questions of law or fact common to class members predominate over any questions affecting only individual members, and that the class action is superior to other available methods for fairly and efficiently adjudicating the controversy.

Class certification is only proper if the court is satisfied, after a rigorous analysis, that the Rule 23 requirements are satisfied (*Wal-Mart Stores, Inc v Dukes*, 564 US 338 (2011)). That analysis, moreover, frequently entails overlap with the merits of plaintiff's underlying claim.

If similar cases are filed in one jurisdiction, they are often consolidated before one judge. Similar cases filed in multiple jurisdictions may be assigned to a single court for some or all proceedings.

Reliance, causation and damages

25 | Can reliance, causation and damages be determined on a class-wide basis, or must they be assessed individually?

Ordinarily, plaintiffs bringing a section 10(b) claim under the Securities Exchange Act of 1934 would face a significant challenge in meeting the requirement that class-wide issues predominate over individual issues for class certification: each putative class member may have purchased the security for different reasons, precluding a finding of predominance due to individualised issues of reliance. The US Supreme Court, however, has recognised two presumptions of reliance that make section 10(b) class actions possible. Under the 'fraud on the market' presumption, courts may presume that all investors rely on the integrity of the market price as reflecting all material public information, including any fraudulent statements, when a stock trades in an efficient market (*Basic Inc v Levinson*, 485 US 224 (1988)). Moreover, in cases involving primarily a failure to disclose, a plaintiff is not required to present positive proof of reliance (*Affiliated Ute Citizens of Utah v United States*, 406 US 128 (1972)). A defendant may seek to rebut a presumption of reliance, including by making a showing that 'severs the link' between the alleged misrepresentation and either the price paid or the decision to trade at that price.

Individualised issues of reliance do not play a role in section 11 or 12(a)(2) actions under the Securities Act of 1933, because reliance is not an element of those claims. A court nonetheless may deny class certification in such cases if defendants provide evidence that certain class members had differing levels of knowledge regarding the misleading nature of the statements or omissions when they invested, sufficient to outweigh commonality.

Individualised damages inquiries typically do not defeat class certification. Rather, at class certification, a plaintiff must only establish that damages are susceptible of measurement across the entire class. Class certification may be denied, however, if the plaintiff's damages model does not attempt to measure damages attributable to its theory of liability (*Comcast Corp v Behrend, 569 US 27 (2013)*).

Court involvement and procedure

26 | What is the involvement of the court in collective proceedings and what procedures must be followed to achieve collective treatment of claims? What is the procedure for settling collective proceedings and what is the extent of the court's involvement in settlement?

The court closely and actively supervises class actions. Before an action may proceed as a class action, the court must determine that the case is suitable for class treatment under the requirements of Rule 23 of the FRCP. Class certification is only proper if the court is satisfied, after a rigorous analysis, that the Rule 23 requirements are satisfied. (*Wal-Mart Stores, Inc v Dukes*, 564 US 338 (2011)).

Courts also must approve class action settlements. Courts closely scrutinise settlements for fairness, weighing the complexity, expense and risks of further litigation against potential recovery. Courts also approve procedures for notifying class members of a settlement and afford them an opportunity to object to the settlement's terms, which are addressed at a hearing.

Opt-in/opt-out

27 | In collective proceedings, are claims opt-in or opt-out?

Most class actions automatically include all members of the defined class, but grant class members the right to opt out. Notice must be provided to all potential class members after the court certifies the class action. Such notice will inform the class members of the time period during which they may opt out and procedures for doing so. A

class member who opts out can pursue an individual action, but cannot recover from the class action. If the class action is settled, a court may offer class members an additional opportunity to opt out of the settlement before it is final.

Regulator and third-party involvement

28 | What role do regulators, professional bodies and other third parties play in collective proceedings?

Classes are represented by private counsel. Counsel for both the class and any defendants often retain independent experts in areas to assist with strategy and offer expert opinion evidence to the court.

Regulators, such as the Securities and Exchange Commission (SEC) or the Commodity Futures Trading Commission, play no direct role in class proceedings. Regulators occasionally seek permission from the court to submit briefs – called amicus briefs – offering the agency's position and perspective. The SEC and other regulators can, however, pursue enforcement actions that may result in monetary and non-monetary settlements or judgments. These parallel enforcement proceedings also may involve SEC requests for information, resulting in defendants submitting materials to the regulators, which can be sought by private class action plaintiffs.

FUNDING AND COSTS

Claim funding

29 | What options are available for plaintiffs to obtain funding for their claims? What are the pros and cons of each option, including any ethical issues relating to litigation funding?

There are several ways plaintiffs can finance their securities claims. A lawyer may agree to a contingency fee arrangement, whereby the lawyer forgoes payment of fees during the pendency of the case in exchange for the right to a percentage of any recovery. Typically, the lawyer also covers expenses until there is a recovery.

Litigation funding also may be available. Litigation funders are third parties who finance a claim in return for a portion of any recovery. The funders also may pay for incidental costs as well as attorney's fees. There is no uniform rule requiring disclosure of funding agreements, but nearly half of federal appellate courts, and approximately a quarter of federal trial courts, have adopted rules or orders that may require disclosing the existence of litigation funders. Litigation funding also may be regulated under state law, depending on the state.

Costs

30 | Who is liable to pay costs in securities litigation? How are they calculated? Are there other procedural issues relevant to costs?

There are various costs that may be incurred in securities litigation, such as filing fees, court reporter and other vendor costs, and attorney's fees. Rules governing the federal courts dictate that routine costs other than attorney's fees usually should be paid by the losing party (Federal Rule of Civil Procedure 54(d)(1)).

The 'American Rule' applies in securities litigation, such that each party typically bears their own attorney's fees. But if a class action is settled, the plaintiff's counsel is commonly paid from the settlement fund. Such payment of counsel's fees is subject to court review to ensure the amount is fair and reasonable.

In rare circumstances, a party may be required to pay the other side's attorney's fees. Section 11(e) of the Securities Act of 1933, for instance, permits a court to award attorney's fees if it concludes a claim or defence was frivolous or asserted in bad faith. In addition, the Private Securities Litigation Reform Act of 1995 provides for sanctions to be imposed, including attorney's fees and costs, if a party or attorney files a complaint, responsive pleading, or dispositive motion that is frivolous or in bad faith.

Privilege

31 | What types of legal privilege exist between litigation funders and litigants?

Courts are divided as to the existence of privilege between litigation funders and litigants. Some courts have found that information provided to a litigation funder may be protected by the work product doctrine. Litigants have argued that they share a 'common interest' with litigation funders, but some courts have rejected those arguments because the shared interest is financial, not legal.

INVESTMENT FUNDS AND STRUCTURED FINANCE

Interests in investment funds

32 | Are there special issues in your jurisdiction with respect to interests in investment funds? What claims are available to investors in a fund against the fund and its directors, and against an investment manager or adviser?

There are a variety of types of investment funds in the United States.

Mutual funds are pools of investment funds collected from a large number of investors and used to invest in securities at the direction of an investment manager, subject to oversight by the fund's directors. Mutual funds are highly regulated, must make detailed disclosures, and both the investment manager and fund directors owe duties of loyalty and care. Shares in the fund may be bought and sold directly with the fund or traded, depending on the fund.

Hedge funds and private equity funds are not subject to the same level of regulation and investment generally is restricted to sophisticated investors. Interests in these funds are not traded – investments must be made directly. Hedge funds may invest in a wide variety of liquid and at times illiquid assets, while private equity funds typically make longer-term investments by acquiring companies and selling them years later.

Broker-dealers are subject to a duty of 'best execution' which requires them to seek for their customer's trade orders the most favourable terms reasonably available under the circumstances. While allegations that a broker-dealer violated the duty of best execution have historically provided a basis for securities class actions, recent federal appellate case law has made it increasingly difficult to maintain private class actions based on alleged violations of the duty.

In addition to federal securities claims, investors also may bring claims against investment managers or directors for failing to manage the funds with loyalty and care. These claims may arise under federal laws or common law.

Structured finance vehicles

33 | Are there special issues in your country in the structured finance context?

Various structured finance vehicles exist in the United States. The most common are asset-backed securitisations (ABS), which pool income-producing assets, such as mortgages or other loans, and issue securities backed by these assets, and collateralised debt obligations (CDOs), which pool ABS or other securities. Securities issued by ABS and CDO vehicles are traded through private transactions.

The party sponsoring an ABS or CDO makes representations and warranties about the underlying assets and structure of the vehicle. If they prove false, certain parties may have the right to demand the

sponsor repurchase defective assets or pay damages. Investors or insurers also may be able to bring claims for fraud under section 10(b) of the Securities Exchange Act of 1934 or common law. Insurers of ABS and CDO vehicles can also assert claims under state insurance laws if a misstatement induced them to provide coverage.

CROSS-BORDER ISSUES

Foreign claimants and securities

34 What are the requirements for foreign residents or for holders of securities purchased in other jurisdictions to bring a successful claim in your jurisdiction?

A foreign citizen can assert federal securities law claims in the United States, but only if the security in question was the subject of a 'domestic transaction' or is listed on a US exchange (*Morrison v National Australian Bank,561 US 247 (2010)*).

There is a circuit split concerning what constitutes a 'domestic transaction.' The First and Ninth Circuit Courts of Appeals have held that, to be a 'domestic transaction', 'irrevocable liability' must have been incurred in the United States, such as through the formation of the contract, placement of purchase orders, passing of title, or an exchange of money. The Second Circuit, however, takes a more defendant-friendly approach to extraterritoriality, under which a defendant may avoid liability by showing that, considering all the facts and circumstances of a transaction, the claims are so predominantly foreign as to be 'impermissibly extraterritorial'.

Foreign defendants and issuers

35 What are the requirements for investors to bring a successful claim in your jurisdiction against foreign defendants or issuers of securities traded on a foreign exchange?

In addition to showing a 'domestic' transaction, plaintiffs seeking to assert claims against foreign defendants or issuers of securities traded on a foreign exchange also must show that the defendant is subject to personal jurisdiction in a US court, which requires purposeful 'minimum contacts' with the United States.

Before a claim against a foreign defendant may proceed, that defendant must be served in a manner consistent with the procedural rules of the US court. That may require compliance with international law, such as the Hague Convention, which can require significant time and expense.

Additionally, a claimant may have to contend with an argument that the US forum is not the appropriate place to sue, relative to an alternative forum that may be more convenient. In some circumstances, the US court may decline to hear the claim.

Multiple cross-border claims

36 How do courts in your jurisdiction deal with multiple securities claims in different jurisdictions?

Where claims are brought in multiple jurisdictions, parties may move, pursuant to the 'inconvenient forum' doctrine, to dismiss claims in certain jurisdictions in favour of focusing the claims in a more convenient forum. Courts tend to be reluctant to disturb a plaintiff's choice of forum, but nonetheless will consider whether the convenience of the parties and witnesses, location of events, accessibility of evidence, trial efficiency, and the interest of justice weigh in favour of requiring the claims to be heard elsewhere.

If parties have agreed to bring claims in a specific venue under a contractual forum selection clause – or a similar clause included in the governing documents of an issuer – courts generally will enforce such provisions.

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Enforcement of foreign judgments

37 What are the requirements in your jurisdiction to enforce foreign court judgments relating to securities transactions?

The enforceability of foreign court judgments is determined by state law and common law. Under the 1962 Uniform Foreign Money Judgments Recognition Act and 2005 Foreign Country Money Judgments Recognition Act, which have been adopted in some form by a majority of US states, a civil judgment will be recognised if it grants or denies a sum of money, is final and conclusive between the parties, and is enforceable in the country in which the judgment was entered. The Model Acts also provide certain additional grounds on which a court may decline to recognise a foreign judgment, such as if the foreign court lacked jurisdiction or if the judgment conflicts with another judgment.

Once a US court has recognised a foreign judgment, it is enforceable in the same manner as a domestic judgment.

ALTERNATIVE DISPUTE RESOLUTION

Options, advantages and disadvantages

38 What alternatives to litigation are available in your jurisdiction to redress losses on securities transactions? What are the advantages and disadvantages of arbitration as compared with litigation in your jurisdiction in securities disputes?

Alternative resolution methods, such as mediation and arbitration, are accepted and common in US securities disputes. Mediation is a non-binding negotiation between the parties guided by a third-party mediator. Arbitration is a more formal court-like process under which a third-party arbitrator makes a final, binding determination. In a recent decision, the Eighth Circuit Court of Appeals struck an investor's class action allegations on the pleadings and directed the investor's securities fraud claims against his broker-dealer to arbitration pursuant to an arbitration clause in the brokerage agreement (*Donelson v Ameriprise Financial Services, Inc, 999 F.3d 1080 (8th Cir. 2021)*).

These approaches tend to be non-public, faster, somewhat less complex, and more cost-effective than traditional litigation, but they often provide for more limited or no discovery and fewer, if any, procedures to challenge claims or appeal results.

UPDATE AND TRENDS

Key developments of the past year

39 What are the most significant recent legal developments in securities litigation in your jurisdiction? What are the current issues of note and trends relating to securities litigation in your jurisdiction? What issues do you foresee arising in the next few years?

The number of new securities class-action filings continued to decline in 2021 – falling 36 per cent over the previous year and reaching the lowest level since 2009. This decrease was driven by a notable decline in new merger-objection suits, which fell by 85 per cent between 2020 and 2021. As the number of new cases fell, so did the value of settlements. The average settlement decreased in value by over 50 per cent in 2021 to US$21 million, the lowest recorded average in the last 10 years. The median settlement value also decreased by 40 per cent from a record high of US$13 million in 2020 to $8 million in 2021. Despite the overall decline in new securities suits, certain types of filings increased, including claims concerning special purpose acquisition companies – corporations formed for the sole purpose of raising investment capital through initial public offering.

The most significant securities legal development of 2021 was the US Supreme Court's opinion in *Goldman Sachs Group, Inc v Arkansas Teacher Retirement System, 594 US ____ (2021)* which vacated a decision of the US Court of Appeals for the Second Circuit affirming certification of a section 10(b) class action under the Securities Exchange Act of 1934. The case concerned the ability of defendants to rebut the fraud-on-the-market (or *Basic*) presumption of reliance available in efficient markets, which is often necessary to achieve certification of putative class actions asserting section 10(b) claims. The Court directed the Second Circuit to consider the 'generic' nature of the alleged misrepresentations in assessing whether defendants had successfully rebutted the *Basic* presumption, and therefore, whether class certification was appropriate. The Court further held that courts at class certification must consider 'all evidence relevant to price impact', which is a prerequisite to invoking the *Basic* presumption, 'regardless whether that evidence overlaps with materiality or any other merits issue'. The Court also held that a defendant seeking to rebut the *Basic* presumption of reliance bears the burden of persuasion to show, by a preponderance of the evidence, that a misrepresentation did not in fact lead to a distortion of the price of a security.

The decision is likely to create a new front in the class certification battleground. Notably, *Goldman* clarifies that the materiality of alleged misrepresentations is relevant to a showing of price impact, and a defendant is entitled to introduce materiality evidence to rebut the fraud-on-the market-presumption at the class certification stage – a conclusion that many courts had previously rejected. And although preserving the fraud-on-the market presumption, *Goldman* confirms that plaintiffs and defendants are on nearly equal footing in establishing whether the presumption applies (through evidence of price impact or lack thereof), subject to a preponderance of the evidence standard. Accordingly, the battle over the fraud-on-the-market presumption – already one of the main events in securities class-action litigation – is likely to grow even more heated in *Goldman*'s aftermath.

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