

Cross-border Offers of Securities in the EU: The *Standard Life* Flotation

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December 15, 2006
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Abstract

This article reviews the use in the flotation of Standard Life plc of the prospectus passport for cross-border offers of securities within the EU that was introduced by the Prospectus Directive (2003). The Standard Life flotation was a major test for the new law on prospectuses and, overall, it came through it well. The prospectus was approved in the UK and the passport mechanism worked smoothly in facilitating the offer of securities into Ireland, Germany and Austria. The Standard Life transaction suggests that national regulatory agencies are willing to make the regime work effectively and to find pragmatic, case-by-case solutions where experience reveals shortcomings in its design. The Committee of European Securities Regulators (CESR) has also played a constructive role.

The article notes that simplification of the passporting regime does not extend as far as civil liability, which remains a complex area. Those contemplating passported share issuance activity within Europe must still take account of multiple, potentially quite divergent, prospectus liability regimes. Jurisdiction and choice of law rules mean that they could be sued in more than one country and liability could be determined under different national laws. The article provides examples of differences between British, Irish and German law on prospectuses that could be relevant to companies that are considering making a passported offer.

This article also considers the role of private enforcement and its interrelationship with public enforcement in the European context. These are particularly hard questions to address from a European perspective because of the nationally fragmented nature of the mechanisms of both public and private enforcement. The article's review of (the lack of) modern British cases on civil liability to investors for prospectus or other disclosures supports the view that levels of private enforcement in Europe are low but the article cautions against attaching too much significance to this finding.

Keywords: securities regulation, prospectuses, disclosure, Europe

JEL classifications: G1, G2, G10, G15, G18, K2, K22, N20

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PART I: INTRODUCTION

A manifestation of a real single securities market in Europe would be a significant amount of cross-border issuance activity by issuers.¹ Shaping regulatory policy so as to promote cross-border offerings of securities has been on the EU policy agenda for many years. As early as 1982 the European Parliament was advocating the idea of a single public offer prospectus that, once approved in one Member State, could be used by issuers to offer their securities on a cross-border basis without the need for further regulatory approvals.² Mutual recognition procedures for prospectuses and listing particulars, which were intended to achieve that objective, were adopted between 1987 and 1989.³ However, these procedures were rarely used. The low usage of mutual recognition was attributed to a number of different causes. One line of analysis explained the low number of cross-border prospectuses on the grounds that they were unnecessary because issuers could attract institutional and retail investors from various Member States simply by listing their securities on an exchange in one country and waiting for investors to come to that exchange.⁴ Linked to this explanation, the persistence of a strong home bias in investment strategies suggested only limited investor, especially retail investor, demand for securities of foreign issuers.⁵ So far as institutional investors were concerned, it was moreover possible for issuers to approach them directly without relying on the mutual recognition procedures by exploiting professional and other exemptions from the requirements for mandatory prospectuses and listing particulars.⁶ The second main line of analysis on why the original mutual recognition procedures did not acquire much practical significance focused on problems in their internal design. The design was seen to be flawed because individual Member States could require prospectuses and listing

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¹ A formal definition of an integrated market is “when the law of one price holds, i.e. when assets generating identical future cash flows command the same return”: Deutsche Bank Research, *Evaluation of the FSAP’s Economic Impact* (December 2006) p 4. However, it is widely accepted that the impact of the FSAP is best assessed against a range of criteria including changes in the structure of corporate finance whereby firms tap into a broader international investor base: *ibid*, p 8.

² N Moloney, *EC Securities Regulation* (OUP, 2002) 198.

³ Directive 87/345/EEC amending Directive 80/390/EEC (First Mutual Recognition Directive) [1987] OJ L185/81; Directive 89/298/EEC coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public [1989] OJ L124/8.

⁴ HS Scott, ‘An Overview of International Finance: Law and Regulation’ in AT Guzman and AO Sykes (eds) *Handbook of International Economic Law* (Edward Elgar Publishing, 2006); HE Jackson and EJ Pan, ‘Regulatory Competition in International Securities Markets: Evidence from Europe in 1999 – Part I’ (2001) 56 *Business Lawyer* 653, 677-8.

⁵ E Ferran, *Building an EU Securities Market* (CUP, 2004) 202 – 3.

⁶ E Ferran, *Building an EU Securities Market* (CUP, 2004) 200 – 1.

particulars to include additional information for their home market and could insist on full translation of the documents. That undermined the appeal of the mutual recognition procedures because of the additional costly complexity involved in tailoring documentation so as to satisfy various different sets of national regulatory requirements.⁷

In the Financial Services Action Plan (FSAP) the European Commission set out an ambitious series of proposals that were intended to promote a more integrated internal financial marketplace and to equip the EU with an upgraded regulatory framework that would enable it to compete more effectively with other markets, especially the US, for international capital. With regard to prospectus passports and mutual recognition, the Commission mainly adopted the second line of analysis.⁸ Its view was that having to produce multiple sets of official documentation prior to cross-border offers of securities thwarted the objectives intended to be achieved by the mutual recognition procedures and a redesign was needed to address that problem.⁹ The Commission did not appear to engage in detailed analysis of the relative seriousness of this problem as compared to investor preferences, market conditions or other factors that could have explained the under-utilisation of the prospectus passport.

The revised design for mutual recognition in the new Prospectus Directive, adopted in 2003,¹⁰ is that a prospectus which is approved by the issuer's home State is valid throughout the EU, without the need for further regulatory approvals, subject only to host States receiving notification from the home State regulator that the prospectus has been drawn up in accordance with the Directive and also a copy of the prospectus and a translation of the summary, where required by the host State.¹¹ Host States cannot impose additional disclosure requirements and must not undertake any approval or administrative procedures relating to prospectuses. The position on the use of different languages is slightly complicated but, essentially, if a cross-border prospectus is written in a language that is customary in the sphere of international finance (such as English), host Member States can require translation only of the summary.¹² The summary should not normally exceed 2,500 words in the original language in which it was drawn up.¹³

During the passage of the Prospectus Directive into law, market participants were rather sceptical about the degree of interest that there would be in the new streamlined procedure for cross-border prospectuses. It was thought that retail equity offerings making use of the prospectus route would remain rare and that issuers would continue to

⁷ Forum of European Securities Commissions, *A 'European Passport' for Issuers* (FESCO/99-098e, 2000) para 8.

⁸ European Commission, *Implementing the Framework for Financial Markets: Action Plan* (COM (1999) 232).

⁹ *Ibid.*, at p 6.

¹⁰ Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, OJ 2003 No. L345/64 (Prospectus Directive).

¹¹ Prospectus Directive, arts 17 and 18.

¹² Prospectus Directive, art 19.

¹³ Prospectus Directive, rec 21.

rely on secondary market linkages to reach geographically dispersed retail investors.¹⁴ Early experience of life under the Prospectus Directive suggests that the prospectus passport is being used, but mainly for prospectuses relating to bonds and derivative securities issued by banks and other financial companies.¹⁵ At least so far as can be seen from data published by the British and Irish securities regulatory authorities, to date there have been relatively few passported cross-border prospectuses relating to straightforward equity and, of these, there were often special circumstances, such as the offer being to existing shareholders (a rights issue or open offer) or to employees, or being in connection with a takeover, that could explain the decision to opt for the passporting route. For example, given the strong Irish fan base for the Scottish football club Celtic and the distinctive nature of share ownership of football clubs in which fans may hold shares,¹⁶ it is not hard to understand the decision to passport into Ireland Celtic plc's UK-approved prospectus relating to an open offer and subscription of new shares.¹⁷

The largest equity offering in which the prospectus passport route has been used thus far is the flotation of Standard Life plc on the London Stock Exchange, where a UK-approved prospectus was passported into Ireland, Germany and Austria. The flotation raised £1.1 billion new equity capital for the Standard Life business. There were special circumstances in this transaction because the flotation was the culmination of the process whereby Standard Life was converted from a mutual association into a quoted plc and the offer of shares included a preferential offer to its existing members in those EU countries, as well as to members in Canada, the Channel Islands, the Isle of Man and the UK. There appears to be no doubt that the international character of the existing ownership structure and business of Standard Life strongly influenced the decision to use the passport route. That the impetus for using the passport was not generally to reach out to retail investors on a cross-border basis is evident from the fact that the non-preferential retail element of the offering was made only to UK investors. Yet it is reasonable to suppose that once the market becomes more familiar with the operation of the passport mechanism and sees it working, albeit for limited purposes, in major transactions such as Standard Life this may encourage companies and their advisers to explore its potential for more general use.

There are several commercial factors that could make issuers more willing to consider seriously the passport option for cross-border general retail equity offerings.¹⁸ First, although the retail market is still quite fragmented, there are emerging signs that

¹⁴ See the discussion in E Ferran, *Building an EU Securities Market* (CUP, 2004) 201 – 2.

¹⁵ E.g., the list of prospectuses that have been passported into the UK from other EU Member States, which is at: <http://www.fsa.gov.uk/ukla/officialProspectusesPassported.do> (accessed December 2006); the list of prospectuses passported into Ireland from other EU Member States, which is at: http://www.ifsra.ie/frame_main.asp?pg=%2Findustry%2Fin%5Fmark%5Fintr%2Easp&nv=%2Findustry%2Fin_nav.asp (accessed December 2006).

¹⁶ Football Governance Research Centre, *The State of the Game The Corporate Governance of Football Clubs 2005* Research Paper 2005 No. 3.

¹⁷ <http://www.celticfc.net/corporate/rissuse/prospectus.pdf> (accessed April 2006).

¹⁸ It should be noted if there is an increase in the incidence of passporting, some of that may have to be attributed to regulatory design rather than issuer choice: under the new Prospectus Directive, and representing a change in the law, equity prospectuses must be approved in their issuer's home State even where the securities are to be offered or admitted to trading only outside the home State: Prospectus Directive, art 13.

consumers across the EU are becoming more interested in acquiring cross-border financial services and products.¹⁹ Secondly, changes in public pension policy are expected to lead to greater retail participation in capital markets.²⁰ Thirdly, there is evidence that the traditional home-State bias in investment is eroding,²¹ at least to the extent of being replaced with a euro-area home bias.²² All such factors mean that there could be increasingly strong commercial advantages for issuers to reach out directly to a wider pool of potential equity investors, especially retail segments, and to utilise the prospectus passport mechanism for that purpose. Regulatory initiatives in the area of retail investor education also potentially point in same direction. Education is increasingly recognised as a critical tool for the protection of retail investors.²³ The European Commission in its White Paper, *Financial Services Policy 2005-2010*, specifically acknowledged that it was essential to help consumers understand financial products to strengthen the demand side and promote good investment choices.²⁴ Through investor education initiatives, better-informed retail investors may become more confident about making investment decisions on a cross border basis.

This article examines the Standard Life flotation with a view to determining what we can learn from it about the practical operation of the new prospectus passport regime. Have the problems that afflicted its predecessor, in terms of a burdensome overload of multiple sets of national regulatory requirements been ironed out? Have new difficulties been created? Are there uncertainties that are costly to resolve? The size and complexity of the Standard Life flotation mean that it can be viewed as a major test for the new EU regulatory regime governing cross-border offers of securities. The insights that can be gleaned from studying it are potentially relevant to broader questions about the long-term viability of the EU's distinctive regulatory and supervisory structure in which rule-making authority is centralised but responsibility for interpretation, application, monitoring and enforcement remains fragmented between the national agencies within the Member States and a network between supervisors (the Committee of European Securities Regulators or CESR) is the mechanism that is meant to promote consistency and convergence in supervisory policies, practices and philosophies.

PART II: AN OVERVIEW OF STANDARD LIFE'S STORY FROM ESTABLISHMENT TO DEMUTUALISATION AND FLOTATION²⁵

The Standard Life Group began business in Edinburgh in 1825, first as a life assurance company under its own Act of Parliament, but from 1925 as a mutual assurance company with no shareholders and with its policyholders as its members. Branch activities in Canada and Ireland were taking place from as early as the 1830s. Standard Life opened a branch in Frankfurt, Germany in 1996 with the aim of exporting its UK life assurance and

¹⁹ European Commission, *Financial Integration Monitor 2005* (SEC (2005) 927).

²⁰ European Commission, *Financial Services Policy 2005-2010* (COM (2005) 629) p 7

²¹ European Commission, *Financial Integration Monitor 2004* (SEC (2004) 559), p 9.

²² L Baele, A Ferrando, P Hördhal, E Krylova and C Monnet, *Measuring Financial Integration in the Euro Area* (2004), ECB Occasional Paper Series No 14, April, p 54.

²³ CESR, *Annual Report* (2005), para 6.1.3.

²⁴ European Commission, *Financial Services Policy 2005-2010* (COM (2005) 629) p 7.

²⁵ This section draws heavily on Part VI of the Registration Note of the Prospectus for the flotation.

pensions operating model into that market. In 1999 it established a Hong Kong business to give the Group a presence in the Far East from which to expand into China, and in 2000 it began to raise its profile in the Indian market. In the 1990s the Group also sought to diversify its operations in areas that were complementary to its core life assurance and pensions business so as to position itself as a provider of a wide range of financial services.

Significant factors that adversely affected Standard Life's business emerged from 2000 onwards. These included: a significant decline in stock market performance between 2001 and 2003 that served to reduce the capital base of many life assurance companies; low inflation and low interest rates that contributed to the prospect of lower long-term investment returns; decline in the popularity of with-profits products with the consequence that the overall risks of the business (which were loaded onto with-profits products) were being carried by a progressively smaller group of people; and a decision by Standard Life that it could no longer afford to offer policyholders additional financial benefits. This combination of pressures led to a strategic review and ultimately to the announcement in October 2005 of the decision to opt for demutualisation and flotation.

The first stage of the demutualisation involved the reorganisation of existing businesses of the Standard Life Group within a corporate structure headed by a Newco, Standard Life plc. This reorganisation was effected pursuant to a scheme of arrangement under Part VII of the Financial Services and Markets Act 2000. As required by Part VII, on 9 June 2006 the Scottish Court of Session approved the demutualisation and flotation proposal, which had previously been approved by 98 per cent of those members who voted on a resolution at a special general meeting on 31 May 2006.

The proposal provided for the membership rights of all of Standard Life's existing members to cease and for those members to receive in compensation either shares in Standard Life plc or cash. Only eligible policyholders in "permitted countries" (that is the countries mentioned in Part I of this article) were entitled to demutualisation shares; policyholders in other countries including the US were to receive cash instead. The proposal also provided for a free share allocation to certain employees of the Standard Life Group. It provided further for the raising of £1.1 billion of net new capital through a preferential offer at a discounted price to members in the permitted countries and certain employees, an institutional offer to institutional investors in the UK, US (utilising Rule 144A and Regulation S), other EU states and elsewhere, and a retail offer to other investors in the UK.

The proposal took effect on 10 July 2006 when Standard Life plc was admitted to the Official List maintained by the UK Financial Services Authority (FSA) and floated on the main market of the London Stock Exchange.

PART III: THE DRAWING UP OF THE STANDARD LIFE PROSPECTUS AND THE OPERATION OF THE PASSPORT: WHAT ISSUES EMERGED?

The Prospectus Directive is meant to work as follows. An issuer that is proposing to offer its securities to the public and/or apply for admission of its securities to trading on a regulated market within the EU must draw up a prospectus that, in form and content, complies with the requirements of the Directive itself and with those of the Prospectus Directive Regulation, which is a secondary measure adopted by the European Commission to prescribe the details of the information to be disclosed in a prospectus.²⁶ The disclosure regime set by the Prospectus Directive and the Prospectus Directive Regulation is one of maximum harmonisation. This means that national regulatory authorities cannot adopt general rules requiring a prospectus to contain items of information which are not included in relevant schedules and building blocks of the Prospectus Directive Regulation.²⁷ An issuer must apply to the competent authority of its home State for regulatory approval of the prospectus before it is published.²⁸ An approved prospectus has Community scope, which means that it is valid for public offers or the admission of the securities to trading on a regulated market in any number of States within the EU.²⁹ The home State authority must, if so requested by the issuer, notify host State authorities that the prospectus has been approved in accordance with the Prospectus Directive and send a copy of the prospectus.³⁰ Host States may require translation of the summary into their official language but host States cannot impose their own approval requirements.³¹ Approved prospectuses must be made available to the public in any one of a number of prescribed ways, including insertions in newspapers circulating in the Member States where the offer is made or admission is sought and on the issuer's website, but need not be sent directly to investors unless they so request.³² Advertisements relating to offers to the public or admission of securities to trading on a regulated market are regulated.³³ Supplementary prospectuses are required in certain circumstances and these must be published in accordance with at least the same arrangements as were applied when the original prospectus was published.³⁴ The publication of a supplementary prospectus triggers investor withdrawal rights,³⁵ as does the publication of a prospectus that does not contain the final offer price, the amount of securities to be offered to be public or the criteria and/or conditions in accordance with which these elements will be determined.³⁶

²⁶ Commission Regulation (CE) 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (Prospectus Directive Regulation).

²⁷ Prospectus Directive, rec 15.

²⁸ Prospectus Directive, art 13.

²⁹ Prospectus Directive, art 17.

³⁰ Prospectus Directive, art 18.

³¹ Prospectus Directive, art 18.

³² Prospectus Directive, art 14.

³³ Prospectus Directive, art 15.

³⁴ Prospectus Directive, art 16.

³⁵ Prospectus Directive, art 16.2.

³⁶ Prospectus Directive, art 8.1.

A. Tri-partite Form of Prospectus

Standard Life was the first major securities offering in the UK to adopt the new tri-partite format for prospectuses introduced by Article 5.3 of the Prospectus Directive. In a tri-partite prospectus the registration document must contain the information relating to the issuer and the securities note must contain the information concerning the securities.³⁷ The third part of the prospectus, the summary, should generally not be longer than 2,500 words in its original language³⁸ and should, in clear and non-technical language, convey the essential characteristics of, and risks associated with, the issuer, any guarantor and the transferable securities to which the issue relates.³⁹ The summary must also contain risk warnings informing readers that it is only an introduction, that investment decisions should be based on the prospectus and that certain pitfalls may be encountered in litigation arising from civil claims relating to prospectus information.⁴⁰ Incorporation by reference is not permitted in summaries.⁴¹

Where a prospectus is in tri-partite form, it is permissible to publish and circulate separately its component parts.⁴² This was a key factor in the Standard Life flotation where the 610-page full prospectus was published in printed form and made available free of charge at the company's registered office and at the offices of its financial advisers and electronically on the company's website but the 13-page summary was mailed directly to over five million members and customers.⁴³ Standard Life's summary exceeded the 2,500 normal word limit. There is room for a divergence of views between national regulators on how restrictively to interpret the requirement that the summary should not generally exceed the 2,500 word limit. So far as the UK is concerned, the FSA has indicated that it will adopt a "reasonably strict" approach but it has acknowledged that there will be circumstances when due to the particularly complex nature of the securities, the 2,500 word limit would make it very difficult, if not impossible, reasonably to explain the "essential characteristics of and risks associated with, the issuer, any guarantor and the transferable securities". In these circumstances, the FSA is prepared to allow the summary to be longer than 2,500 words, but not excessively so.⁴⁴ This pragmatic response to a potential problem with the design of the Prospectus Directive seems sensible. What magic, after all, is there in 2,500 as the word limit? The underlying philosophy is reasonably clear and straightforward - retail investors should not be swamped by more information than they can reasonably be expected to absorb – and a guideline length of some sort is appropriate to facilitate the emergence of standard practices that allow investors more easily to compare information. But applying it rigidly

³⁷ Prospectus Directive, art 5.3.

³⁸ Prospectus Directive, rec 21.

³⁹ FSMA 2000, s 87A(6).

⁴⁰ See the *Prospectus Rules*, 2.1.7R. These rules are part of the FSA Handbook.

⁴¹ *Prospectus Rules*, 2.4.4R.

⁴² Prospectus Directive, art 14.5.

⁴³ 'Standard Life Launches Share Offers', Standard Life Press Release, 15 June 2006.

⁴⁴ *List!* (Issue 10, June 2005). *List!* is a UK Listing Authority newsletter that seeks to give broad coverage of topical issues of both a technical and non-technical nature. It does not give formal guidance but it provides valuable insights to the FSA's thinking on issues. *List!* is accessible via <http://www.fsa.gov.uk/Pages/Library/Communication/NewsLetters/newsletters/index.shtml>

could undermine the quality of the information supplied to retail investors, especially in complex cases.

Designing the optimal regulatory system for the protection of retail investors is not easy. While the basic proposition that retail financial services markets need to be regulated more closely than wholesale markets may be broadly uncontroversial, once the debate moves onto a more detailed level of analysis considerable divergence on the combination of regulatory strategies that can best achieve an adequate level of retail investor protection at acceptable cost opens up.⁴⁵ Information disclosure plays an important role as it can mitigate the obvious problems of inadequate and asymmetric information faced by retail investors but, at the same time, the inability of many retail investors to understand and utilize information serves to limit both the usefulness of mandatory disclosure requirements for retail investors and the justifications for the imposition of compliance costs on firms. The FSAP, of which the Prospectus Directive was one outcome, was mainly focused on wholesale markets and arguably one of its key weaknesses was that insofar as it affected retail financial markets, it was based on inadequate evidence of retail investor behaviour and appropriate regulatory responses, limited understanding of real consumer needs and insecure foundational assumptions about the merits of widening retail investor participation in financial markets and about the relationship between law and market activity.⁴⁶ Lessons have been learnt for the future - retail financial services has been identified as a priority in the post-FSAP era and the European Commission has explicitly acknowledged the need for work in this area to be “bottom-up, based on extensive consultations, working with the grain of the market, taking into account the interaction between existing legislation and new initiatives”⁴⁷ – but the market must live with imperfect policy choices that have already been made. In relation to the prospectus summary requirement, it is vulnerable in certain respects to the charge of being inadequately thought through. Take for instance the adaptations to UK market practice on providing summary information to retail investors, discussed next in this article (see Part III.B), which were prompted by Prospectus Directive. Since the new practice does not appear to improve significantly the position of retail investors, it is possible to question whether it was worthwhile to force this change onto the market. The same charge of lack of in-depth analysis can also be leveled against aspects of the new rules on translations of prospectus, which are also discussed later in this article (see Part III.C). The new prospectus disclosure regime countenances the possibility of summaries being in a different language from the main body of the prospectus, which is very helpful from the perspective of issuers as it relieves them of the burden of translation costs but there is at least a perceived tension with a fundamental principle of consumer law that information should be full and written in plain language that consumers can readily understand.⁴⁸

⁴⁵ D Llewellyn, *The Economic Rationale for Financial Regulation* (FSA Occasional Paper No 1, 1999) provides a general survey of the economic rationale for financial regulation.

⁴⁶ N Moloney, ‘Building a Retail Investment Culture Through Law; the 2004 Markets in Financial Instruments Directive’ (2005) 6 *European Business Organization Law Review* 341

⁴⁷ European Commission, *Financial Services Policy 2005-2010* (COM (2005) 629) p. 13.

⁴⁸ See Part IV.C.

B. Summaries and advertisements – a new way of presenting shortened disclosure documents

It used to be a common practice in the UK market for issuers to use mini-prospectuses in their offerings to prospective retail investors.⁴⁹ Mini-prospectuses, as such, are not contemplated by the regime established by the Prospectus Directive. Where issuers want to use shortened disclosure documents, circulation of the summary of a tri-partite prospectus is an option, as demonstrated in the Standard Life flotation, but the normal word limit, even with some room for flexibility, is considerably shorter than the length of old-style mini-prospectuses.⁵⁰ Alternatively, or additionally, issuers can issue advertisements, which are not subject to a specific word limit but which must comply with certain disclosure requirements set by the Prospectus Directive that are intended to make it plain that an advertisement is not a prospectus and that information in it is accurate and consistent with the prospectus.⁵¹ This option was also used in the Standard Life flotation. Standard Life published as advertisements guides to buying shares in the retail offer, buying shares in the preferential offer, and receiving demutualisation shares. As required by the regulatory regime, each of the guides contained prominent wording at the front to the effect that it was not a prospectus but an advertisement relating to Standard Life, that prospective investors should not subscribe for or purchase any shares in Standard Life except on the basis of the information contained in the prospectus, and giving details of how copies of the prospectus could be obtained.

The summary plus advertisements approach adopted by Standard Life looks set to become the new standard practice in the London market for retail-oriented offers. Prospectus summaries benefit from a partial liability shield (as discussed in Part IV of this article) but advertisements do not, a factor that may influence decisions about the contents of the various documents to the extent that issuers have discretion in this respect. Article 24 of the Prospectus Directive Regulation appears to leave issuers with considerable room for manoeuvre in that it provides for the issuer to determine *on its own* the detailed content of a prospectus summary, but this discretion is constrained by Article 5 of the Prospectus Directive which requires the summary to convey essential characteristics and risks associated with the issuer and the securities. The summary in the Standard Life flotation introduced the demutualisation and flotation proposal, indicated the intended use of the proceeds and the company's intended dividend policy, outlined the business of the Standard Life Group, explained recent background events whereby the Group was being repositioned, summarised the Group's key strengths and strategy, stated the directors' beliefs on current trading and prospects, provided selected summary financial information and summarised risk factors. The share guides contained more basic

⁴⁹ *Listing Rules* 8.12R and 8.13R (pre July 2005). This practice emerged in the 1980s in the wave of privatisations that were aimed at retail as well as wholesale investors. It was widely used again in the late 1990s when many "dot.com" and technology company flotations were structured so as to include a retail element.

⁵⁰ The options are discussed by the FSA in *List!* (Issue 11, Sept 2005), para 3.

⁵¹ Prospectus Directive, art 15. Advertisements will be subject to national laws regulating investment advertisements such as the UK financial promotions regime under Financial Services and Markets Act 2000, s 21.

and quite general information about shares and share ownership and explained the mechanics of the options available to potential investors.

C. Cross-border Implications of the Use of a Tri-partite Prospectus and Circulation of Shortened Disclosure Documents

Even though the length of the summary in Standard Life's prospectus exceeded the 2,500 normal word limit, this did not prove to be problematic in the passporting process. Were a home State to be very lax in monitoring the length of summaries it is possible that this could become controversial but a realistic approach, such as that adopted by the UK FSA, seems unlikely to trouble anyone. Since host States can require prospectus summaries to be translated into their official languages, there is an inbuilt incentive in the system for issuers to control their length. The German version of the prospectus was two pages longer than the original English version.

The German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (known as BaFin), insisted on the publication of a formal notice stating how the Standard Life prospectus has been made available to the public and where it could be obtained by the public. This administrative requirement sits uneasily with the Prospectus Directive which permits only home States to require the publication of formal notices⁵² (an option which the UK FSA, when acting as home State, has not exercised) and does not allow host States to undertake any administrative procedures with regard to prospectuses.⁵³ CESR's view is that host States cannot require issuers to publish formal notices.⁵⁴ This is an example of inconsistent interpretation of the Directive between different national competent authorities that was exposed by the Standard Life flotation. CESR's intervention may generate some pressure on individual national agencies to adjust their interpretations where these are out of line with the prevailing majority view.

D. Prospectus Contents

The contents of the registration document and securities note are prescribed in very considerable detail by the Prospectus Directive Regulation. Additionally, there are CESR's recommendations for the consistent implementation of prospectus requirements.⁵⁵ The CESR recommendations provide clarification in relation to issues such as working capital disclosure, profit forecasts, capitalisation and indebtedness and also on the detailed disclosure items under the Regulation. These recommendations are not binding in EU law but CESR members are introducing them into their national requirements on a voluntary basis. This voluntary incorporation has taken place in the UK: the FSA requires issuers to have regard to the CESR recommendations and will take account of them in the prospectus approval process.⁵⁶ Detailed stipulation of prospectus

⁵² Prospectus Directive, art 14.3.

⁵³ Prospectus Directive, art 17.1.

⁵⁴ CESR, *Frequently Asked Questions Regarding Prospectuses: Common Positions Agreed by CESR Members* (CESR/06-296d, July 2006).

⁵⁵ CESR, *Recommendations for the Consistent Implementation of the European Commission's Regulation on Prospectuses No 809/2004* (CESR/05-054b).

⁵⁶ *Prospectus Rules*, 1.1.6G and 1.1.8G.

contents, supported by centralised interpretation, is a strategy that is designed to minimise the risk of inconsistent implementation of the regime by national authorities. However, it is hard to think of everything in advance and it is virtually inevitable that questions will arise in practice on which there is no precise rule or, as may be, crystal clear guidance. This was certainly the case in relation to the contents of the Standard Life prospectus.

Historical financial information

Standard Life's accounts presented some special features that were not anticipated specifically by the disclosure regime. The Prospectus Directive Regulation requires the registration document in a prospectus relating to shares of a Community issuer to contain audited historical financial information covering the latest three financial years and the audit report in respect of each year. Such financial information must be prepared according to the IAS Regulation, or if not applicable, to a Member State's national accounting standards.⁵⁷ Furthermore, the last two years audited historical financial information must be presented and prepared in a form consistent with that which will be adopted in the issuer's next published annual financial statements having regard to accounting standards and policies and legislation applicable to such annual financial statements. The CESR recommendations provide guidance on these requirements and a number of worked examples.⁵⁸ Standard Life's position was that its accounts for 2005 had been prepared on the basis of International Financial Reporting Standards (IFRS) but the 2003 and 2004 accounts had been drawn up under UK GAAP. This situation was not covered precisely by an example in the CESR recommendations but its guidance to the effect that an issuer is required completely to restate all of the financial information covering the last two financial years where this is not consistent with the form to be adopted in the issuer's next accounts indicated that the 2004 accounts needed to be restated (and audited). Furthermore, this was a situation where it was appropriate to use the "bridge approach" approach advocated by CESR, whereby the middle period (2004) was presented twice, once restated in accordance with IFRS and once under GAAP. Not covered at all, however, in the recommendations or in the disclosure requirements was the fact that Standard Life was changing status from a mutual assurance company owned by its members to a public company limited by shares. The solution that was devised to address this issue and to ensure proper comparability of financial performance over the three years was for the IFRS accounts for 2005 and 2004 and the UK GAAP accounts for 2004 and 2003 to be prepared and presented so as to show the results that would have been attributable to shareholders and policyholders had Standard Life been a company during those years.

Price range prospectus

The Standard Life prospectus did not give the exact offer price for either the general or the preferential offer. Instead it gave an indicative offer price in the range of 210 pence to 270 pence per ordinary share for the general offer and stated that the preferential offer

⁵⁷ Prospectus Directive Regulation, Annex I, item 20.1.

⁵⁸ CESR, *Recommendations for the Consistent Implementation of the European Commission's Regulation on Prospectuses No 809/2004* (CESR/05-054b) paras 51 – 73.

would be at a 5 per cent discount (and therefore in the range of 119.5 pence to 256.5 pence per ordinary share). It stated further that the offer prices eventually determined might be outside the indicative price ranges and that a number of factors would be taken into consideration in determining the final prices including market conditions, the number of demutualisation shares offered for sale, demand under the offers, the prices bid to acquire the shares in the institutional offer and the desire to establish an orderly after-market in the ordinary shares. It identified the issuer as the person who would determine the final prices in consultation with the co-sponsors of the flotation. The general offer price was subsequently set at 230p per share and the preferential offer price at 218.5p per share, a 5 per cent discount to the general offer price.⁵⁹

Price range prospectuses have received heightened attention under the new regulatory regime because of the provision in the Prospectus Directive for investors to be entitled to withdraw from the purchase or subscription of securities where the final offer price is not included in the prospectus save where the criteria and/or conditions by which it will be determined are disclosed in the prospectus.⁶⁰ There are no provisions in the Prospectus Directive Regulation or CESR recommendations that amplify the requirement to specify determinative criteria or conditions⁶¹ but UK regulatory practice has come down quickly in favour of accepting that price range prospectuses in the form followed by Standard Life avoid withdrawal rights problems, at least where the final price is within the indicative price range. Where the final price is not within the indicative price range, a supplementary prospectus may be required, in which case its publication would trigger withdrawal rights.⁶²

An issuer must send a pricing statement to its home State competent authority as soon as the price is determined.⁶³ The form and content of a pricing statement are not subject to regulation. The statement must be published in accordance with the rules governing the publication of prospectuses generally but there is no specific requirement in the Prospectus Directive or the Prospectus Directive Regulation to send it to potential investors or even to host State regulators. In practice, however, host State regulators will expect to receive a copy.⁶⁴

E. Cross-border Consistent Implementation of Prospectus Content Requirements

It is unrealistic and, arguably, undesirable to aim for a pan-European regulatory regime for prospectuses in which every last detail is covered by a specific rule and every point on

⁵⁹ Standard Life Press Release, 7 July 2006

⁶⁰ Prospectus Directive, art 8.1.

⁶¹ Prospectus Directive Regulation, Annex III, item 5.3 states only that there must be stated the method for determining the offer price, including a statement as to who has set the criteria or is formally responsible for the determination.

⁶² J Inglis and B Dulieu, 'The Prospectus Directive: Business As Usual a Year On?' (2006) 17(5) *Practical Law for Companies* 23, 27.

⁶³ Prospectus Directive, art 8.2.

⁶⁴ CESR, *Frequently Asked Questions Regarding Prospectuses: Common Positions Agreed by CESR Members* (CESR/06-296d, July 2006).

which there is room for uncertainty has been anticipated and addressed by CESR guidance. Such a regime would be liable to collapse under its own weight. The Standard Life flotation demonstrates that the current system, in which there is room for national securities regulators in dialogue with the transacting parties and their advisers to determine points of uncertainty, can be made to work well, with the FSA, as the home State regulator in that transaction, dealing with matters to the evident satisfaction of the various host States. It was only in relation to the publication of a formal notice that there a difference of views between the national authorities on the entitlements of home and host States under the Directive.

Yet leaving it to national regulators to interpret points of uncertainty undoubtedly carries with it the obvious risk of inconsistent implementation. This is where CESR, as the co-ordinating network, can play a valuable role.⁶⁵ In July 2006 CESR published a “Q and A” publication relating to prospectuses that outlined common positions agreed by CESR Members and also some points where views diverged.⁶⁶ This document, which was produced at the behest of market participants, is intended to provide the market with responses in a quick and efficient manner to everyday questions which are commonly posed to the CESR Secretariat or CESR members. It is quite possible that experience gleaned from the Standard Life flotation is reflected in its contents: the document includes responses on cross-border publication of pricing statements and on formal notices, which were issues that were relevant in relation to Standard Life.

The publication of a “Q and A” document of this sort is clearly not a headline-grabbing initiative and it even could seem rather mundane. Yet it is worth highlighting as a positive example of CESR’s role as a facilitator of the convergent functioning of supervisors’ operational work and the smooth functioning of the markets. It is sensible for CESR to focus on improving mechanisms for the pooling and publication of regulatory know-how that has been hammered out on the anvil of real transactional experience. The benefits for market participants and regulators of being able easily to tap into the results of such experience are readily apparent.⁶⁷

PART IV: PROSPECTUS LIABILITY AND USE OF THE PASSPORT

A. Interplay Between Public and Private Enforcement of Securities Laws

Putting together a prospectus of any sort is a complex and time-consuming process.⁶⁸ The outline timetable for a straightforward IPO suggested by a leading text on UK law allows

⁶⁵ For a discussion of CESR’s role, see E Ferran, *Building an EU Securities Market* (CUP, 2004), pp 78 – 81.

⁶⁶ CESR, *Frequently Asked Questions Regarding Prospectuses: Common Positions Agreed by CESR Members* (CESR/06-296d, July 2006).

⁶⁷ Practical guidance is also being published at national level: see FSA, *Passporting Fact Sheet* (UKLA Publications, Factsheet No 4, October 2006).

⁶⁸ M Sabine, *Corporate Finance: Flotations, Equity Issues and Acquisitions* (Butterworths, 3rd edn, 2003) ch 7.

a period of up to two months for the drafting of the prospectus.⁶⁹ That timetable presupposes the prior completion of the accountants' long-form report that is usually the first step in the preparatory work, so the overall timetable may be considerably longer.⁷⁰ Elaborate legal and financial due diligence exercises will take place to identify problems that need to be addressed and to gather information that will be included in the prospectus. Detailed verification notes indicating the fact-checking process that has been undertaken in respect of prospectus statements will be prepared.⁷¹ Where regulatory approval of the prospectus is required, that has to be built into the timetable. The UK FSA requires new applicants to submit the draft prospectus at least 20 working days before the intended approval date but the approval process can often take longer.⁷²

Various factors drive the careful effort that goes into the process of compiling a prospectus. The need to obtain regulatory approval (where applicable) is an obvious one. So too is the threat of public enforcement by the regulator or by the criminal authorities. The publication of a prospectus containing false information could be a breach of listing rules or market abuse for which monetary administrative penalties can be imposed by the regulatory authorities⁷³ and in some circumstances it could also amount to a criminal offence.⁷⁴ Potential civil liability to investors who have suffered loss as a consequence of the false prospectus is also relevant.

The interplay between public and private enforcement in relation to securities market activity is an issue that has attracted much academic attention recently. Influential law and finance scholarship has linked the development of stock markets with measures of private enforcement such as extensive disclosure requirements and special securities law civil remedies that facilitate claims by investors by stating clearly the elements that need to be proved in order to win the case and including features, such as a lighter burden of proof or a wide range of persons who can be sued, that are more favourable than contract and tort law.⁷⁵ There is no reason to doubt that special civil remedies in securities laws have the potential to boost investor confidence in the quality of prospectus information by reducing the incentives for issuers and their directors to provide inaccurate information. Furthermore, by clearly extending the range of potential defendants to some of the advisers on a public issue of securities as well as the issuer and its directors, civil liability provisions in securities laws could reinforce the concern of intermediaries for their reputation and help to ensure that they will perform properly their key investor protection function of filtering out false or misleading information.⁷⁶

⁶⁹ *Gore-Browne on Companies* (Jordans, loose-leaf) paras 40 [48] – 40 [50].

⁷⁰ *Ibid*, 40 [5].

⁷¹ *Ibid*, 40 [44].

⁷² *Listing Rules*, PR 3.1.3.

⁷³ See the Financial Services and Markets Act 2000, Pt 6 (Listing) and Pt 8 (market abuse).

⁷⁴ See the Financial Services and Markets Act 2000, s 397.

⁷⁵ R La Porta, F Lopez-de-Silanes and A Shleifer, 'What Works in Securities Laws?' (2006) 61 *Journal of Finance* 1. The methodology of this work is controversial: MS Siems, 'What Does Not Work in Comparing Securities Laws: A Critique on La Porta et al.'s Methodology' (2005) *International Company and Commercial Law Review* 300.

⁷⁶ BS Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48 *UCLA Law Review* 81.

However, there are some curiosities about the strong emphasis on private enforcement as it does not appear to be entirely consistent with the way in which private enforcement works in practice.⁷⁷ The much-debated and often criticized US experience of private enforcement through the securities class action suggests that private enforcement is at best an imperfect tool.⁷⁸ The European experience also suggests that a degree of scepticism about the role of private enforcement is appropriate, albeit for different reasons from those that typically concern critics of the US system. The European perspective, essentially, is that there is under-utilisation of private mechanisms of enforcement by aggrieved investors.

Ferrarini and Giudici, for example, point to the fact that investors in the scandal-hit Italian company, Parmalat, looked to the US rather than the Italian courts for civil relief and attribute this course of events to Europe's unfriendly approach to private enforcement of collective interests.⁷⁹ They argue for the introduction of class action-like mechanisms in Europe, as well as the recognition of contingency fee arrangements and the upgrading of discovery and other civil procedure rules. They comment that: "In the absence of fact pleading and discovery rules, in Europe any serious hope that investor claims could take a significant role in the enforcement of securities law is ungrounded."

British experience with regard to liability for prospectus and other disclosures to the market also suggests that private enforcement plays only a quite limited role.

Special securities law civil claim relating to prospectuses

The UK does have a special securities law claim in s 90 of the Financial Services and Markets Act 2000 (previously s 150 of the Financial Services Act 1986) whereby issuers, their directors and advisers can be held personally liable to compensate investors for false prospectuses or listing particulars. The elements that an investor has to establish in a statutory claim are less onerous than for common law negligence or misrepresentation (see further Part IV.C). However, there is no reported case of an investor succeeding in bringing a claim for compensation under the special statutory regime in the 2000 Act or its 1986 predecessor. Nor is there much evidence in the reported decisions of investors even commencing such claims – the Lexis-Nexis database from 1986 onwards reveals just one case where aggrieved investors in a rights issue tainted by an inaccurate set of listing particulars sought orders for discovery to obtain documentary evidence and information with a view to establishing whether it would be worthwhile to sue the issuer's accountants under s 150 or for common law negligence. The application was rejected on grounds relating to civil procedure rules on discovery.⁸⁰ (The investors' case

⁷⁷ HE Jackson and MJ Roe, 'Public Enforcement of Securities Laws: Preliminary Evidence' (draft, October 2006).

⁷⁸ Ibid.

⁷⁹ GA Ferrarini and P Giudici, 'Financial Scandals and the Role of Private Enforcement: The Parmalat Case' in J Armour and JA McCahery (eds), *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Hart Publishing, 2006).

⁸⁰ *Axa Equity and Law Life Assurance Society plc and others v National Westminster Bank plc* Chancery Division 2 February 1998, Court of Appeal 7 May 1998.

against the accountants and the company's banks was eventually settled out of court; the company's managing director was convicted of fraud and given an 8 year prison sentence.⁸¹⁾

Common law negligence/misrepresentation cases relating to prospectuses

Modern British common law negligence or misrepresentation cases relating to prospectuses are also thin on the ground. Apart from the *Axa Equity* case mentioned in the previous paragraph,⁸² a Lexis-Nexis search for the period from 1986 reveals only two other reported cases involving a claim by investors for breach of a common law duty of care in relation to the contents of a securities prospectus. In the first case the defendant directors succeeded in having significant elements of the statement of claim against them struck out on the grounds that they disclosed no reasonable cause of action.⁸³ In the second case, the court took a more favourable view of the claimants' position and held that it was at least arguable that the defendants had assumed and owed a duty of care to those investors who relied on the contents of the prospectus in making secondary market purchases.⁸⁴ However, there is no record of either case proceeding to a full trial on the merits. Of course, a preliminary ruling that there is (or is not) a case to answer may suffice to bring about an agreement between the parties on an out-of-court settlement of the substantive issues.⁸⁵ One further case involved a preliminary skirmish in an action by investors against the sponsor of an issue of prospectuses to raise subscriptions for shares in companies where it was alleged that there were material misrepresentations in the prospectuses.⁸⁶ An internet report suggests that the action was settled out of court.⁸⁷

Common law negligence/misrepresentation cases in private placings and M&A transactions

This is not to say that the civil law is wholly irrelevant in transactions involving the acquisition of securities. Broadening the search (over the same period) to private placements of securities and M&A transactions does produce examples of investors seeking to use the general civil law to obtain compensation where an investment in shares had turned sour and the problems could be traced back to financial or other information supplied by or on behalf of the company in whose shares they had invested. Cases can be found where investors succeeded in claiming compensation from companies and/or their

⁸¹ J. Willcock, 'Resort Hotels Chief Jailed for Eight Years', *The Independent* (London), April 2, 1997, Business Section, p 21.k

⁸² *Abbott v Strong* [1998] 2 BCLC 420, is another case arising from the same facts as the *Axa Equity* case. The decision concerned the scope of the statement of claim as it related to Coopers but it is clear from the report that the directors of the company were also sued.

⁸³ *Al-Nakib Investments (Jersey) Ltd v Longcroft* [1990] 3 All ER 321, [1990] 1 WLR 1390, [1990] BCC 517.

⁸⁴ *Possfund Custodian Trustee Ltd v Diamond* [1996] 2 All ER 774, [1996] 1 WLR 1351, [1996] 2 BCLC 665.

⁸⁵ M Percival, 'After *Caparo* - Liability in Business Transactions Revisited' (1991) 54 *Modern Law Review* 739, 742.

⁸⁶ *Ward v Guinness Mahon & Co Ltd* [1996] 4 All ER 112, CA.

⁸⁷ <http://www.leonkaye.co.uk/recent.htm> (accessed December 2006) (website of law firm acting on the case on behalf of investors).

directors on the grounds that they had been induced by fraudulent or negligent misrepresentations to enter into share sale and purchase or subscription agreements.⁸⁸ There are also plenty of preliminary rulings on procedural or other aspects of entitlements to pursue such claims.⁸⁹ However, these cases have limited relevance in relation to arms-length market transactions with which this article is primarily concerned because the high threshold for fraud or deceit liability limits its operation in this context. Indeed, it was recognition of those limitations that lay behind the enactment of a special statutory securities law claim in relation to prospectuses back in the Directors Liability Act of 1890, the predecessor of s 90 of the Financial Services and Markets Act 2000. A negligent misrepresentation claim under s 2(1) of the Misrepresentation Act 1967 has a lower liability threshold but the impact of this mechanism in market transactions is also limited by reason of the fact that it is only available to claimants who can establish a direct contractual nexus with the maker of the offending statement.

Another civil law claim that features in cases reported during the period involving M&A transactions is of investors suing for breach of the common law duty of care. This area of the law is dominated by the leading case of *Caparo v Dickman* where it was held that auditors conducting the statutory audit of a company did not owe a duty of care to a bidder for the company. The boundaries of *Caparo* have been tested in a line of subsequent cases exploring the special circumstances in which such a duty of care could arise,⁹⁰ but overall the British courts have tended to adopt a restrictive approach and have hesitated to impose duties of care in relation to anyone other than the accountants' or auditors' immediate clients.⁹¹ There are also a few cases where directors of a target company were later sued by the bidder company for breach of a duty of care in the preparation of financial or other information relied on by the bidder in making the bid but

⁸⁸ E.g., *Bottin (International) Investments Ltd v Venson Group plc* [2006] All ER (D) 111 (Dec) (company and directors liable for fraudulent misrepresentations in financial information that had induced investor to subscribe for preference shares); *Man Nutzfahrzeuge AG v Freightliner Ltd* [2005] EWHC 2347 (vendor of company's shares vicariously liable to purchaser for fraudulent information about financial position provided by company's financial controller).

⁸⁹ E.g., *Capital Trust Investments Ltd v Radio Design TJ AB* [2002] EWCA Civ 135, [2002] 2 All ER 159, (proceedings against the defendant claiming damages for deceit or negligent misrepresentation or both in connection with an allotment of preference shares; stay of proceedings ordered because, on a proper construction of their agreement, the parties had agreed to arbitration); *Soden v British & Commonwealth Holdings plc* [1998] AC 298 (action by administrators to determine for purposes of Insolvency Act 1986 the treatment of any sums that might be awarded in favour of parent company in action against a failed subsidiary and its directors claiming damages for negligent misrepresentation said to have induced the share purchase).

⁹⁰ Including *Galoo Ltd v Bright Graham Murray* [1995] 1 All ER 16; *Morgan Crucible Co plc v Hill Samuel & Co Ltd* [1991] Ch. 295, [1991] 1 All ER 148; *Peach Publishing Limited v Slater & Co (a firm)* [1999] BCC 139, CA; *Electra Private Equity Partners v KPMG Peat Marwick* [2001] 1 BCLC 589; *Royal Bank of Scotland v Bannerman, Johnstone, Maclay* [2003] SLT 181, [2005] CSIH 39; *Man Nutzfahrzeuge AG v Freightliner Ltd* [2005] EWHC 2347.

⁹¹ M Simpson (ed), *Professional Negligence and Liability* (LLP, looseleaf), para 13.38. However, it is likely that a duty of care to investors would be owed by accountants in respect of work done for inclusion in a prospectus or other offer document: *ibid*, paras 13.89 – 13.90. *Kripps v Tiouche Ross & Co* (1997) 35 CCLT (2d) 60, BC CA.

none where the claim proceeded to full trial and the claimants succeeded in being awarded compensation.⁹²

The pattern that emerges from these recent British civil law cases on liability for disclosures by companies, directors and advisers can be interpreted as being broadly consistent with Ferrarini and Giudici's more wide-ranging work on the Italian position: investors in the UK markets do not look much to the British courts for redress. This puts in question the significance of private enforcement as a mechanism in the modern UK regulatory toolkit.

Public enforcement, on the other hand, is a growth area in the UK. Since 2000 more than 70 cases brought by the FSA have resulted in administrative penalties and six cases have been pursued through the criminal court system.⁹³ Only a few of these cases have related to false disclosures but they include one of the most high profile actions brought by the FSA thus far, which resulted in a monetary administrative penalty of £17 million being imposed on Shell/Royal Dutch Petroleum Company for market abuse and breaches of the *Listing Rules* in respect of false or misleading announcements to the market.⁹⁴ Shell agreed to pay this fine without admitting or denying the findings or conclusions. On the criminal side, in 2005 the FSA brought its first prosecution for false statements and was successful in obtaining convictions against former directors, who were given prison sentences. Commenting on the criminal case the FSA's Director of Enforcement emphasized that the efficient operation of the markets depended on investors' ability to rely on information released by companies and that directors could expect to be held personally responsible for the announcements they made to the market.⁹⁵

So what conclusions can we draw about the interplay between public and private enforcement? It is obvious that the number of successful cases, whether on the private or public side, has only limited informative value in determining the most effective incentives for directors, financial advisers and others involved in prospectus or other disclosures to focus on ensuring that the information is accurate and complete. There is an important distinction to be drawn between "outputs" – a quantitative measurement, such as of numbers of cases – and "outcomes" – whereby the impact regulatory requirements may have had is assessed.⁹⁶ For one thing outputs alone do not tell us much

⁹² *Partco Group Ltd v Wragg* [2002] 2 BCLC 323 (allegations of fraud, negligence and breach of fiduciary duties against former directors; held: not appropriate to dismiss case summarily as issues deserved a full trial); *Morgan Crucible Co plc v Hill Samuel & Co Ltd* [1991] Ch 295 (action by bidder against the former advisers, accountants and directors of the target alleging breach of a duty of care by negligent misrepresentations in financial and other statements; pleadings disclosed a reasonable cause of action which should be allowed to go to trial) The *Caparo* litigation also involved a claim against the directors, but for fraud rather than negligence.

⁹³ RB, Macrory *Regulatory Justice: Making Sanctions Effective* (Final Report, November 2006) para 3.19. This report was commissioned by the Government. It is accessible at http://www.cabinetoffice.gov.uk/regulation/documents/pdf/macrory_penalties.pdf

⁹⁴ FSA Final Notice, August 2004.

⁹⁵ *R v Rigby, Bailey and Rowley* (August 2005). FSA/PN/091/2005 18 August 2005 and FSA/PN/106/2005, 7 October 2005.

⁹⁶ This distinction is emphasised in RB, Macrory *Regulatory Justice: Making Sanctions Effective* (Final Report, November 2006) para 2.12.

about the effectiveness of the threat of enforcement as a deterrent. Admittedly, enforcement and deterrence are entwined as effective enforcement is an important signal in achieving deterrence.⁹⁷ The fact that there have been few past cases could suggest civil litigation is a relatively low-level risk compared to the possibility of public enforcement, and that it is therefore only a weak deterrent. However, careful market participants and their advisers will be aware that they cannot afford to be too complacent about civil litigation risks because there is always the possibility of a future developments that could have adverse ramifications even for completed transactions, such as a test case that changes the common law with retrospective as well as prospective effect,⁹⁸ a change in the rules governing the standing of claimants or otherwise smoothing the process by which claims are brought,⁹⁹ or broader market developments, such as the emergence of more activist investors who view civil litigation more favourably as a potential mechanism for obtaining redress. Furthermore the incidence of private settlements that are concluded entirely behind the scenes without anything leaking out into the public domain is obviously unknown but it is not fanciful to suppose that such payouts are made in circumstances where powerful institutional investors have a credible basis for challenging the accuracy of a disclosure.

Another respect in which the number of decided cases where investors have sued successfully for compensation is only part of the story is that it does not take account of the strain that preparing a defence to a possible claim would place on managerial time and emotions and its other direct and indirect costs. Quite consistently with an intention to produce disclosures that are complete and candid, responsible persons may worry about the risks of being caught up in even the early stages of threatened civil litigation. It is helpful for some purposes to distinguish between “litigation risk” – the risk of being sued – and “liability risk” – the risk of actually losing the case and being held liable to pay compensation. The maker of a statement can control liability risk by being candid, complete and accurate but litigation risk is much less manageable as it is affected by factors, such as investors’ willingness to sue and the robustness of the courts in dismissing hopeless cases at an early stage, that are outside the maker’s direct control.

⁹⁷ Ibid, para 1.21.

⁹⁸ The established practice of judicial precedent derived from the common law is that overruling of earlier decisions has retrospective and prospective effect. The House of Lords has acknowledged that there could be circumstances where retrospective overruling would have such gravely unfair and disruptive consequences for past transactions or happenings that the House of Lords would be compelled to depart from the normal principles relating to the retrospective and prospective effect of court decisions but that such circumstances would be altogether exceptional: *In re Spectrum Plus Ltd (in liquidation)* [2005] UKHL 41, [2005] 2 AC 680, HL.

⁹⁹ For example, the adoption of a statutory derivative action in the UK Companies Act 2006, which clarifies the circumstances in which shareholders can pursue claims on their company’s behalf and which extends the law by permitting a derivative action to be brought in relation to allegations of negligence, has prompted much concern about the potential for more lawsuits against directors: D Lightman, ‘Boards Beware! Lawyers Loom’ *The Times* (London) September 12, 2006, Law Section, p 6.

Recent discussion in the UK prompted by the EU Transparency Directive,¹⁰⁰ which regulates the periodic disclosure of information by issuers with securities admitted to trading on regulated markets suggests that liability and litigation risks in respect of disclosures are not a peripheral concern for directors and others, notwithstanding the paucity of modern cases that are directly in point. A new statutory liability regime for Transparency Directive-related disclosures has been inserted in the Financial Services and Markets Act 2000 by the Companies Act 2006.¹⁰¹ This liability attaches to issuers but directors are expressly shielded from liability. During the passage of the new companies legislation into law there was considerable pressure to extend the safe harbour from civil liability that the new regime affords to directors to other types of disclosure. The Government chose not to amend the new statutory regime but it did accept that the liability and litigation risks facing directors and others were sufficiently serious to warrant a detailed examination of the public policy considerations surrounding the establishment of a comprehensive liability regime that covered all financial disclosures and it appointed Professor Paul Davies of the London School of Economics to conduct this review on its behalf.¹⁰²

B. How Liability and Litigation Risk Concerns May Affect Passporting Decisions

Concerns relating to potential civil liability are relevant to decisions on whether or not to make a cross-border offering of securities on the basis of a passported prospectus because not passporting provides a shield against the possibility of parallel proceedings in various jurisdictions and the associated intensified litigation-risk burdens. Some European bodies have argued for an “issuer nationality” approach to liability for securities disclosures – whereby liability would be governed by the law of the country of incorporation of the issuer rather than by the law of the countries in which harm occurs¹⁰³ – but policymakers have not yet been fully persuaded by the merits of this approach.¹⁰⁴ Instead, the prevailing approach envisages the possibility of multiple suits in various countries in which liability is governed by different national laws.

Civil jurisdiction within the EU is regulated by the EC Regulation No 44/2001 (the Brussels Regulation) which, as a general rule, allocates jurisdiction on the basis of domicile of the defendant¹⁰⁵ but which, in tort claims (i.e. claims where a defendant’s non-contractual civil liability is in question), provides also for jurisdiction in the courts of

¹⁰⁰ Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ 2004 No. L390/38.

¹⁰¹ See now Financial Services and Markets Act 2006, s 90A.

¹⁰² Hansard HL Vol 685, 26 Oct 2006, Col WS121

¹⁰³ Financial Markets Law Committee, *Issue 76 – Transparency Obligations Directive* (January 2004).

¹⁰⁴ However, as the Financial Markets Law Committee has pointed out in the memorandum noted in the previous note, a place of company incorporation approach to auditor liability has been accepted in the Rome II Regulation context and it can be argued that the logic underpinning that exception (essentially that audit is closely tied to company law) should apply also in relation to the liability of a company and its officers.

¹⁰⁵ The domicile of legal persons is determined by art 60, which provides three possible solutions: the statutory seat, or the place of the central administration or the principal place of business of the company.

the location of the harmful event.¹⁰⁶ The place where the damage occurs¹⁰⁷ is the general rule for the choice of law governing a tort claim,¹⁰⁸ which is to be regulated by the EC Rome II Regulation once the legislative process in respect of that measure has been completed and it comes into force thereafter.¹⁰⁹

As yet there is only limited EU-wide harmonisation of the mechanisms of private enforcement of securities laws. This is a specific aspect of a much broader point, namely, that the EU still remains far away from being a genuine European area of justice in civil and commercial matters in which people can approach courts and authorities in any Member State as easily as in their own.¹¹⁰ In the financial markets field the current emphasis is mainly on the development of out-of-court dispute resolution mechanisms.¹¹¹ The substantive content of national civil liability claims is not harmonised. Thus the Prospectus Directive ventures only very tentatively into the field of civil liability by requiring Member States to apply their national laws on civil liability at least to issuers or their administrative, supervisory or management bodies, whilst saying nothing about the contents of these laws.¹¹² This means that those contemplating passported share issuance activity within Europe must still take account of multiple, potentially quite divergent, prospectus liability regimes and consider the strain of possibility being involved in litigation under several different legal systems.

¹⁰⁶ Brussels Regulation, art 5 (3). This place can be either where the harm was directly suffered or where the acts giving rise to the harm were done (*Bier v Mines de Potasse* C 21/76 [1976] ECR 1735). The claimant has a free choice between these two (or more) courts as an alternative to the courts of the defendant's domicile. Locating financial loss can be challenging (see for example, *Marinari v Lloyds Bank* C 364/93 [1995] ECR I 2719 and *Dumez France v Hessische Landesbank* [1990] ECR I 49). These add to the uncertainties which an issuer may face in determining where a suit might be brought. However, there is a movement towards limiting the jurisdiction of the court under art 5(3) to the damage suffered within that jurisdiction (*Shevill v Presse Alliance* [1995] ECR I 415 [1995] ECR I 415). That may prevent parallel litigation on the same damage, but will permit a claimant to split up the claim to pursue an issuer in several jurisdictions.

¹⁰⁷ Art 4(1) applies the law of that country "irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country or countries in which the indirect consequences of that event occur".

¹⁰⁸ There are exceptions to the general rule, including one where there is a "manifestly closer connection" with another country, which could be based in a pre-existing relationship or a contract between the parties to the litigation. The limits and applicability of the exception will require elucidation from the European Court of Justice, if the experience follows that of the similar wording in the Rome Convention on contractual obligations.

¹⁰⁹ The Council adopted a common position in September 2006. The co-decision legislative process applies and therefore the European Parliament must also approve it. However, note the Commission's response at 13551/06, which suggests that it may still be some time before the new Regulation is finalised. See further T Petch, 'The Rome II Regulation: An Update' (2006) 21 (8) *Journal of International Banking Law and Regulation* 449.

¹¹⁰ The task of the civil justice unit within the Justice, Freedom and Security Directorate of the European Commission is to promote the creation of a European justice area. See further http://ec.europa.eu/dgs/justice_home/judicialcivil/dg_judicialcivil_en.htm (accessed July 2006). M Andenas, 'National Paradigms of Civil Enforcement: Mutual Recognition or Harmonization in Europe?' (2006) 17 *European Business Law Review* 529.

¹¹¹ European Commission, *Financial Services Policy 2005-2010* (COM (2005) 629) p. 8 emphasises the important role played by FIN-NET, a network of national consumer complaints schemes, by providing users and consumers with easy access to out-of-court complaint procedures in cross-border cases.

¹¹² Prospectus Directive, art 6.2. See also, Transparency Directive, rec 10 and art 7.

C. Examples of Differences Between National Liability Regimes with Potential Ramifications for Cross-border Flotations

The UK Financial Services and Markets Act 2000 (FSMA) (which has been amended to implement the Prospectus Directive), s 90 allows investors to claim compensation for false and misleading statements in, or omissions from, prospectuses. In covering omissions as well as positive misstatements and half truths, the FSMA claim is more favourable than the civil sanctions under the general law relating to misrepresentation. The FSMA claim is also available to a potentially larger group of aggrieved investors than other civil sanctions in that secondary market purchasers as well as original investors can sue.¹¹³ A wide range of responsible persons against whom a FSMA claim can be brought is clearly set out.¹¹⁴ The category includes the directors of the issuer and other persons who are required to give responsibility statements in the prospectus. This list includes reporting accountants in respect of the financial information, but not sponsors. Having a list of responsible persons is doubly advantageous to investors compared to other civil sanctions because its clarity means that they are relieved of the burden of showing that statements are attributable to particular persons and its broad scope increases the chances of finding a sufficiently deep financial pocket to cover the amount of any damages awarded. The elements that an investor must establish in order to succeed are softer than in relation to other civil sanctions; in particular, there is no need to show reliance on the inaccurate information. There is a partial FSMA liability shield for prospectus summaries: statutory liability will attach to persons who are responsible for the summary but only if the summary is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus.¹¹⁵ There are certain defences available to persons who are prima facie responsible for the contents of a prospectus and therefore liable to be sued under FSMA.¹¹⁶

As envisaged by the Prospectus Directive,¹¹⁷ UK prospectus law makes offerors as well as issuers responsible for prospectus contents.¹¹⁸ However, an offeror is not responsible for a prospectus if the issuer is responsible, the prospectus was drawn up primarily by the issuer or on its behalf and the offeror is making the offer in association with the issuer.¹¹⁹ This ensures that persons such as the Standard Life policyholders who chose to sell their demutualisation shares alongside the offer of new shares by the company do not run the risk of being held financially liable for the contents of a prospectus over which they have had no control.

However, selling shareholder liability can be an issue in a cross-border context. A problem arises, for example, under Irish law, which is one of the countries into which

¹¹³ FSMA 2000, s 90 is available to any person who has acquired securities and suffered loss in respect of them that is attributable to the inaccurate prospectus.

¹¹⁴ *Prospectus Rules*, 5.5.

¹¹⁵ FSMA 2000, s 90(12).

¹¹⁶ FSMA 2000, sch 10.

¹¹⁷ Prospectus Directive, art 6.1.

¹¹⁸ *Prospectus Rules*, 5.5.3(d)R.

¹¹⁹ *Prospectus Rules*, 5.5.7R.

Standard Life passported its offer. In Ireland statutory liability to pay compensation to persons who acquire securities on the faith of a false or incomplete prospectus arises under the Investment Funds, Companies and Miscellaneous Provisions Act 2005, s 41. Selling shareholders are included in the category of persons who have this statutory liability and in the context of a passported offer there is no provision qualifying their responsibility in circumstances where the primary responsibility for the prospectus lies with the issuer. Although the Irish Prospectus (Directive 2003/71/EC) Regulations 2005 are similar to the UK position in that they provide for offerors to be responsible for a prospectus save where the offer is made in association with the issuer and the issuer is primarily responsible for the prospectus,¹²⁰ the rules on responsibility under these Regulations apply only where Ireland is the home State.¹²¹ Where Ireland is not the home State, all offerors are potentially responsible. The problem can be resolved by structuring the offer such that Irish resident investors are offered only new shares issued by the company, thereby ensuring that selling shareholders are not offerors in Ireland. So the difficulties are not insurmountable but they will require (costly) specialist legal advice to determine their precise significance in a transaction-specific context and to achieve a solution that is legally and practically workable.

Certain liability-related issues also arise in relation to Germany, another of the countries into which the Standard Life offer was made. There are concerns about the implications under German consumer protection laws of mailing a German translation of the summary of an English-language prospectus to potential investors. The partial shield against civil liability for summaries provided by the Prospectus Directive has been fully implemented into German law¹²² but the operation of the shield in cross-border contexts where more than one language is involved is open to question because of EU-wide consumer protection laws that emphasise the need for plain, intelligible language and for consumers to have the opportunity to examine all the terms.¹²³ Failure to meet the standards required by consumer protection laws can result in terms being not binding on the consumer, which is not something that the prospectus liability shield would protect against. The prospect of two EU-wide regulatory regimes being significantly at odds with each other is clearly an unattractive conclusion that reasonable persons would resist but the tension between the regime for securities offerings, where it is accepted that translation burdens need to be eased so as not to deter cross-border activity, and consumer law is not altogether easy to resolve. German debate on this issue highlights the fact that the prospectus rules are merely one part of a larger and often very complex set of relevant requirements, especially in offerings with a retail component, that need to be considered.

D. Deciding Whether to Use the Passport

¹²⁰ SI 324/2005 (Ireland), sch 1, para 6.

¹²¹ *Ibid*, reg 31(1).

¹²² Prospectus Directive Implementation Act (Prospektrichtlinie-Umsetzungsgesetz or PDIA) of 22 June 2005.

¹²³ Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts [1993] OJ L95/29. This point is also discussed in S Revell and E Cole, 'Practical Issues Arising from the Implementation of the Prospectus Directive – What Are the Equity Capital Markets Worrying About?' [2006] *Capital Markets Law Journal* 77, 83.

It is evident that use of the passport will, notwithstanding the Prospectus Directive, involve obtaining detailed advice from local lawyers on prospectus liability and wider legal implications of offering securities into their jurisdiction. It seems inevitable that this legal advice will be complex, both as to what the legal rules in each country are and on how they work in practice under generally applicable rules of civil procedure. Even the list of persons who potentially face prospectus liability is liable to differ from country to country because the Prospectus Directive only specifies in a minimalist way the persons who must be deemed by national law to be responsible for the prospectus and exposed to civil liability. For instance, sponsors to an issue are not included in the list of persons who can be sued under s 90 FSMA but they could potentially be exposed to equivalent liabilities in other countries. The position of selling shareholders can also vary from country to country as noted in C. above. With regard to litigation risk, the advice may well indicate country-by-country variations in investors' willingness to pursue prospectus liability claims, perhaps because such claims are simpler in some countries than in others or because of more general differences in national legal systems or in levels of investor/shareholder activism. At some point, the issuer's board and its advisers will need to take a commercial decision on whether it is worthwhile to run the risk of parallel different prospectus liability proceedings in several countries. Of course, this will be only one of the many issues that will be weighed in the balance before the structure of the offering is determined, but it does not appear to be a marginal or trivial concern. Standard Life, it may be noted, only used the passport to make a preferential offer to members and employees and only in those EU countries outside the UK in which it already had a significant retail presence; it was not a "full" retail cross-border offering. It is not clear how far considerations about potential liabilities affected the determination of the structure but they could well have played a part.

E. Secondary Market Developments

Pan-European passporting is an opt-in regime. In this respect (as in many others), the EU regime is very different to that in the US where the securities laws have pan-US offerings at their heart and intrastate offerings operate under an exemption.¹²⁴ However, the element of choice that the Prospectus Directive continues to give to issuers with regard to where they make their primary offerings contrasts with the Transparency Directive which imposes new periodic financial disclosure obligations on issuers with securities admitted to trading on any regulated market and, with a view to promoting integration, requires this information to be disseminated throughout the EU so that all investors are on an equal footing with regard to access to investment information.¹²⁵ Member States are required to reinforce the disclosure obligations with appropriate liability rules attaching at least to the issuer.¹²⁶ Once admitted to a regulated market, issuers must therefore contend with the prospect of multi-jurisdictional litigation in respect of their periodic disclosures

¹²⁴ Securities Act 1933, section 3(a)(110 and Rule 147.

¹²⁵ Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, [2004] OJ L390/38.

¹²⁶ Transparency Directive, rec 10 and art 7.

as liability could arise in each of the jurisdictions in which the information is received and acted upon.¹²⁷ Of course, in a sense there is nothing new here because, even before the Transparency Directive, issuers with publicly-quoted shares faced the risk that investors in various countries might acquire their securities and later sue in their local courts. However, the Transparency Directive has led to concerns in some quarters of an increased risk of multiple civil liability suits under different national laws, for example because, even though national laws may remain the same, investors may find it easier to establish the factors (such as receipt of information within the jurisdiction) on which liability depends or because the Directive may have a dynamic effect on Member States' liability laws and result in the enactment of new remedies that are more favourable to investors. EU deliberations on the harmonisation of conflict of laws rules for torts (including negligent misstatement) may eventually prove to be the forum for the resolution of the debate sparked by the concerns about the liability ramifications of the Transparency Directive, but in the meantime the position is tricky and uncertain.

The heightened potential for multiple periodic disclosure civil liability suits by investors in the secondary market that results from the Transparency Directive could indirectly influence decisions on whether to use the passport in the primary market, but precisely how it would affect such decisions is rather unclear and may depend on the particular circumstances of the issuer. The view taken by an issuer that has already taken the step of having its securities admitted to trading on a regulated market and which is considering a rights issue or some form of secondary offering seems likely to be influenced by the fact that cross-border liability and litigation risks are matters with which it should be already familiar in the context of its periodic disclosures as that familiarity should enable it to make a more informed assessment of the burden that would be involved in managing prospectus-related liability and litigation risks. The considerations for a new entrant at the time of its flotation onto a regulated market may be quite different. At that point in an issuer's life, limiting the jurisdictional scope of the primary market offering by not passporting may still appear to be a valuable strategy for managing liability and litigation risks, notwithstanding the exposure to secondary market liability risks that will open up after flotation. The considerations for a company that is making a public offer within the Prospectus Directive but not seeking to have its securities admitted to trading on a regulated market (and therefore not subject to the Transparency Directive) could well be different again.

PART V: CONCLUSION

The Standard Life flotation was a major test for the new EU law on prospectuses and, overall, it came through it well. The prospectus passport mechanism worked quite

¹²⁷ This issue has been considered in some detail by the UK Financial Markets Law Committee, which identifies issues of legal uncertainty in the framework of the wholesale financial markets and considers how such issues should be addressed. See *Issue 76 – Transparency Obligations Directive* (January 2004); *Issue 76 – Transparency Obligations Directive* (October 2004) and *Issue 76 – Transparency Obligations Directive* (September 2006). These memoranda together with an exchange of correspondence between Lord Woolf (FMLC) and Alexander Schaub (European Commission) are available via the FMLC website (fmlc.org).

smoothly in facilitating the offer of securities into Ireland, Germany and Austria. Only one issue on which there was a difference of views on the powers of home and host State regulators emerged and that was with regard to an administrative matter, namely whether host States could insist on the publication of formal notices, rather than an issue going to the heart of the transaction. In these early days of the new regime, transactions such as Standard Life represent significant learning experiences for those involved in them. CESR is proving to be a useful conduit for the dissemination of such learning by gathering together questions that market participants have asked of national competent authorities and publishing responses to them that represent common positions agreed by CESR Members.

The simplification of the passporting regime does not extend as far as civil liability, which remains a complex area. Those contemplating passported share issuance activity within Europe must still take account of multiple, potentially quite divergent, prospectus liability regimes. Jurisdiction and choice of law rules mean that they could be sued in more than one country and liability could be determined under different national laws. Detailed advice from local lawyers on prospectus liability and wider legal implications of offering securities into their jurisdiction is still required.

The Prospectus Directive allows issuers to choose whether to offer their securities on the cross-border basis by means of a passported prospectus. The option of not passporting as a tool for managing liability and litigation risks associated with prospectuses is thus available. That consideration may have influenced the structure of the Standard Life flotation where the passport was used only for the purposes of a preferential offer to members and employees and only in those EU countries outside the UK in which it already had a significant retail presence. It was not a “full” retail cross-border offering. However, for issuers that take the step of having their securities admitted to trading on a regulated market, cross-border liability and litigation risks associated with periodic disclosures cannot be easily sidestepped because of requirements under the Transparency Directive for the pan-European dissemination of information.

Public enforcement through national securities regulators and the co-ordination of their efforts through CESR have tended to be the policy priorities in recent years but the Prospectus and, especially, Transparency Directives are moving private enforcement towards the foreground of policy discussion. It is evident, too, that civil liability and litigation risks are being viewed with increasing concern by the market as regulatory developments enhance their intensity. The growing prominence of these concerns could be thought rather curious given the low levels of actual enforcement by investors. This article provides a review of modern British cases on liability to investors for disclosures and concludes that liability is rarely imposed. However, it seems unlikely that the growing attention being paid to private enforcement is wholly misplaced. Quite what role private enforcement plays and its interrelationship with public enforcement are particular hard questions to address in the European context because of the nationally fragmented nature of the mechanisms of both public and private enforcement but it is clear that the number of decided cases is only one small piece of this large and complex jigsaw.