

Section 90 of FSMA

Time for collective action?

Jonathan Cary and Jo Rickard of Shearman & Sterling (London) LLP outline the basis on which shareholder action groups may bring claims under section 90 of the Financial Services and Markets Act 2000.

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Shareholder activism has found its voice in recent months with a number of high-profile interventions over executive remuneration. That voice may soon resonate loudly in the English courts as shareholder action groups threaten collective actions against the Royal Bank of Scotland Group plc (RBS) and the Lloyds TSB Group plc (Lloyds) in relation to prospectuses published by those banks in the midst of the financial crisis (*see box “RBS and Lloyds action groups”*).

Those action groups have threatened claims under section 90 of the Financial Services and Markets Act 2000 (FSMA) (section 90), which provides a statutory remedy for misstatements or omissions in listing particulars and prospectuses. However, although section 90 provides a clearly defined cause of action, it is a form of redress that has not been pursued by claimants to date.

This article considers:

- The legal basis on which shareholder action groups may bring a claim under section 90.
- The procedural mechanisms by which collective actions may be brought in England and Wales.
- The reasons why such claims may not yet have been commenced.



Given the prospect of an increase in these types of claims, we also outline practical guidance for issuers to help limit potential liability (*see box “Practical guidance for issuers”*).

SECTION 90 CLAIMS

A company is generally required to publish listing particulars or a prospectus when making an offer to the public of transferable securities, or

when seeking to have such securities admitted to trading on a regulated market.

Statutory liability for misstatements in prospectuses has been a feature of English law since the Directors' Liability Act 1890 and subsequently in the Companies Acts and the Financial Services Act 1986. The modern form of redress is contained in section 90.

Basis for liability

Under section 90, liability is imposed for any untrue or misleading statement in listing particulars or prospectuses, or the omission of any matters that are required to be included (*see box "Section 90 of FSMA"*).

Whether a statement is "untrue" or "misleading" is a question of fact which will be judged objectively. Although FSMA does not make the point explicitly, the time at which the truth or accuracy of the relevant statement is to be tested appears to be the time when the listing particulars or prospectus is sent to the competent authority (currently, the Financial Services Authority).

Information requirements

Sections 80(1) and 87A(2) of FSMA respectively provide that listing particulars and prospectuses must contain all information that investors and their advisers reasonably require, and would reasonably expect, for the purposes of making an informed assessment of: the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities; and the rights attaching to those securities. This is in addition to any other specific information required by the relevant listing rules or the competent authority.

In determining what information should be included, one must have regard to a number of factors, such as the nature of the issuer and the persons likely to acquire the securities (*sections 80(4) and 87A(4)*).

Under sections 81 and 87G respectively, an issuer must publish supplementary listing particulars or a supplementary prospectus in circumstances where there is a "significant change affecting any matter" contained in the listing particulars or prospectus or where a "significant new matter arises".

Potential defendants

The person responsible for listing particulars and prospectuses may be liable to pay compensation for misstatements

Section 90 of FSMA

Section 90 of the Financial Services and Markets Act 2000 (FSMA) makes any person who is responsible for listing particulars and prospectuses (together with supplementary listing particulars and prospectuses) liable to compensate a person who has:

- Acquired or contracted to acquire securities to which the listing particulars or prospectus applies; and
- Suffered loss as a result of either:
 - any untrue or misleading statement in the listing particulars or prospectus; or
 - the omission from the listing particulars or prospectus of any matters required to be included by sections 80, 81 and 82 of FSMA in the case of listing particulars and supplementary listing particulars, and sections 87A, 87G and 87B of FSMA in the case of prospectuses and supplementary prospectuses.

Section 90 does not cover misstatements or omissions in an issuer's periodic financial disclosures (for example, annual and half-yearly reports and accounts), or in information published to the market by means of a recognised information service: these are both subject to the compensation regime in section 90A of FSMA (*for more information on section 90A, see feature article "Statutory regime for issuer liability: extending the scope", www.practicallaw.com/7-503-9800*).

or omissions in those documents. FSMA does not define who is a person responsible for listing particulars or prospectuses. Instead, this is set out in regulation 6 of the Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001 (*SI 2001/2956*), and includes:

- The issuer of the securities. Where the issuer is a body corporate, this will be the company itself.
- Each director of the issuer at the time that the listing particulars or prospectus was submitted to the relevant authority.
- Any person who has authorised himself to be named (and is named) in the listing particulars or prospectus as a director or as having agreed to become a director "either immediately or at a future time".
- Any person who accepts, and is stated in the listing particulars or prospectus as accepting, responsibility for the contents.

- Any person not falling within any of the categories above who has authorised the contents.

Professional advisers, such as investment banks and accountancy firms, may fall within this latter category, but will not be "responsible" for the listing particulars or prospectus if they have simply given advice as to its contents.

Potential claimants

A claimant must have acquired securities to which the listing particulars or prospectus apply, or have contracted to acquire them or an interest in them (*section 90(1)(7)*). Accordingly, a claimant need not be the registered owner of the securities, but may, for example, have entered into an option agreement to buy them.

A claimant who has acquired or contracted to acquire securities need only demonstrate that he has suffered loss as a result of the misstatement or omission. He does not need to show that he relied on the misstatement in the listing particulars or prospectus in making

the acquisition; it is sufficient that the market price was affected and led to the claimant suffering a loss.

This is a significant and material departure from the provisions of the earlier statutes and the position under both the Misrepresentation Act 1967 (1967 Act) and the common law (see “Other forms of claim” below). It also makes this element of the liability functionally equivalent to the “fraud on the market” doctrine in US securities law. The fraud on the market doctrine assumes that where securities are traded in an efficient market, all public information is reflected in the market price. The US courts will therefore presume that a claimant relied on the alleged material misstatements or omissions when making the decision to trade in the securities.

There remains some uncertainty as to whether section 90 also extends to after-market buyers (that is, secondary buyers of securities that have already been issued and subsequently traded by the original subscriber). The view preferred by commentators is that it does.

The defences

The defences (or, as they are termed, “exemptions”) are in Schedule 10 to FSMA. Broadly, it is a defence to a claim under section 90 where:

- The defendant reasonably believed that a statement was true and not misleading or that an omission was properly made. Essentially, therefore, it is a defence for the defendant to show that he was not negligent.
- The relevant statement was made by an “expert” (such as a professional adviser) who the defendant reasonably believed was competent to make the statement, and had consented to the statement’s inclusion in the form and context in which it was included.
- A correction of an untrue or misleading statement, or a notice that an “expert” was not competent or had not consented to the inclusion

RBS and Lloyds action groups

The RBS Rights Issue Group and the RBoS Shareholders Action Group (with approximately 8,000 and 7,000 members respectively) are proposing to commence claims against the Royal Bank of Scotland Group plc (RBS) (and certain former directors) in respect of the £12 billion rights issue announced by the bank in April 2008 (see *News brief “RBS rights issue: a sign of the times”*, www.practicallaw.com/7-382-0130).

The action groups have sent pre-action letters alleging that the prospectus failed to present RBS’s financial position accurately, and it omitted to disclose material information. The chairman of the RBoS Shareholders Action Group has suggested that litigation is the only avenue available to the action group after what he described as a failure by the Financial Services Authority to address certain issues in its report published in December 2011 (www.practicallaw.com/8-517-3204).

Lloyds Action Now has approximately 8,000 members and claims, among other things, that the prospectus published by Lloyds TSB Group plc in November 2008 in respect of its placing and open offer failed to present the financial position of HBOS plc accurately and did not disclose that HBOS had received emergency funding from a variety of sources. The action group has indicated that it is seeking to obtain third party funding and ATE (after the event) insurance before it commences proceedings.

of his statement, was published (or the defendant took all reasonable steps to try and secure such publication and reasonably believed that publication had taken place) before the claimant acquired the securities.

- If accurately and fairly reproduced, the relevant statement was made by an “official person” or was contained in a “public official document”.
- The claimant acquired the securities with knowledge that the statement was false or misleading, or with knowledge of the omitted matter.

Measure of compensation

Section 90 provides that a defendant is liable to compensate the claimant for loss he has suffered in respect of the securities as a result of the misstatement or omission. However, FSMA does not outline the measure of damages, nor is it the subject of any direct authority. Commentators do not agree on whether the appropriate measure is that in the tort of deceit (which would enable recovery of all losses which have flowed

naturally from acquiring the securities) or the tort of negligent misstatement (which would confine damages to the consequences of the statement being false or misleading).

It is inevitable that this will be a key battleground between claimants and defendants in early claims brought under section 90 as the difference in damages is potentially huge. Even where there is consensus as to the appropriate measure of damages, there remains scope for substantial disagreement as to the quantum of damages.

Other forms of claim

As section 90(6) makes clear, the remedies available under section 90 are not exclusive, and a claimant may pursue another claim as well as, or instead of, a claim under section 90; for example, claims under section 2(1) of the 1967 Act, under the common law tort of deceit, or for negligent misstatement.

A detailed assessment of these causes of action is beyond the scope of this article, but each has immediate potential disadvantages compared to a claim under section 90. Specifically, a claim under the

1967 Act requires there to be a contractual relationship between claimant and defendant(s), a claim for deceit requires the claimant to satisfy the high hurdle required to plead and prove fraud, and a claim for negligent misstatement requires the defendant to have owed a duty of care to the claimant. In respect of each of these claims, a claimant is also required to demonstrate reliance on the alleged misstatement.

As outlined above, section 90 dispenses with this requirement, and, further, directors of the issuer may be defendants in a claim under section 90, which is not the case under the other causes of action.

COLLECTIVE ACTIONS

Given the number of claimants seeking redress, a multi-party action is likely to be the most appropriate means by which an action group will proceed.

Although claims on behalf of a class of claimants are not nearly as common as in the US, or certain other jurisdictions, the English courts have extensive experience in handling multi-party litigation.

Procedural mechanisms

There are currently three alternative procedural mechanisms that the courts may use in order to manage group claims:

Joinder and consolidation. The Civil Procedure Rules (CPR) permit that any number of claimants or defendants, and any number of claims, may be covered by one action (*CPR 19.1 and CPR 7.3*).

Representative actions. It is relatively uncommon for representative actions to be brought in claims for damages. However, broadly, in a representative action, a representative party brings a claim on behalf of himself and others with the “same interest” (*CPR 19.6*). Only the representative is a party in the proper sense, but the court’s judgment is binding on all members of the group represented.

Group Litigation Orders (GLOs). GLOs were introduced into civil procedure with the introduction of the CPR

Practical guidance for issuers

Given the increased risk of claims by shareholder action groups under section 90 of the Financial Services and Markets Act 2000 (section 90), issuers may be wise to consider taking the following action in relation to the listing particulars or prospectus that they are proposing to publish:

Preparation

- Review internal procedures and guidelines in place governing the verification and approval of information to be contained in listing particulars or prospectuses.
- Where advisers or third parties are responsible for information to be contained in the listing particulars or prospectus, ensure that this is recognised and specifically stated in the listing particulars or prospectus where appropriate.

Before publication

- Consider the public offerings of securities insurance (POSI) policy carefully in order to ensure that it provides adequate cover.
- Review the directors’ and officers’ (D&O) insurance policy to ensure that the risk of claims against directors under section 90 is adequately covered.

After publication

- Address any shareholder complaints promptly and involve the legal team early, especially when responding in writing.
- Maintain a dialogue with shareholders, particularly major institutional investors.
- Ensure that any internal review carried out is conducted in a manner that will attract legal professional privilege.
- Notify any claims to insurers without delay.

in 2000 in response to a perceived weakness of the rules governing representative actions.

The court may make a GLO where claims give rise to “common or related issues” of fact or law (*CPR 19.10*). The test is therefore wider than the “same interest” test required for representative actions.

Claims under section 90 would appear to be particularly well suited to the GLO procedure. Given that there is no requirement for each individual claimant to demonstrate reliance, the claims of all members of an action group would be expected to give rise to common or related issues of both fact and law (or, indeed, potentially demonstrate the same interest for the purposes of a representative action).

The GLO is an “opt-in” procedure: all claimants must file an individual claim form. A claimant enjoys both membership of the group and the status of a party to the proceedings. This does, however, mean that each claimant is individually liable for his share of the defendant’s costs if the claim is unsuccessful.

Class action reform?

Calls for a modern class action “opt-out” regime in England and Wales have been made forcibly but sporadically, although the appetite for reform appears to have diminished in recent years.

In December 2008, the Civil Justice Council (the advisory body responsible for overseeing and co-ordinating the modernisation of the civil justice system) published its final recommendations on the issue of collective redress in

the UK. It concluded that there is an unmet need to reform the collective redress mechanisms in English civil procedure.

The introduction of an opt-out collective actions regime for financial services claims was subsequently mooted in the Financial Services Bill 2009, but it was a casualty of the legislative “wash-up” which followed the announcement of the general election in April 2010.

However, since then, there have been few material developments, save for the consultation on competition law private actions, published on 24 April 2012, which includes proposals for a new “opt-out” collective action for competition claims on behalf of both consumers and businesses in the Competition Appeal Tribunal (*see News brief “Private actions in competition law: BIS consults on reform”, www.practicallaw.com/9-519-6238*).

In February 2011, the European Commission (the Commission) launched a public consultation aimed at identifying common legal principles to underpin any future EU initiatives on collective redress and to explore the fields in which new procedures for collective redress might be desirable. In its draft report published on 15 July 2011, the European Parliament’s Committee for Legal Affairs stated that the Commission had not put forward convincing evidence that action is required. That position softened somewhat in the final version of the report adopted by resolution on 2 February 2012, which simply asks the Commission to demonstrate in its impact assessment that action is needed at EU level.

The Commission’s work programme for 2012 includes “An EU framework for collective redress” for the fourth quarter of the year, but any reform, if pursued, is likely to be a long way off.

UNDERUSE OF SECTION 90

As section 90 provides a clearly defined statutory form of redress, and English civil procedure makes available established mechanisms for collective redress, why have no action groups (or,

Litigation funding

Conditional fee agreement (CFA). Under a CFA, the law firm agrees to accept a reduced fee (or even no fee) throughout the course of the litigation. If the litigation is ultimately unsuccessful, the client does not have to pay any further fee to the law firm (although they may be subject to a court order requiring them to pay the other side’s costs). However, if the litigation is successful, the law firm will be entitled not only to recover its standard fees but also a “success fee” which could be up to 100% of its standard fees.

Third party funding. A third party funder pays the costs of the claim on the basis that, if the claim is successful, the funder will receive a share of the proceeds of the litigation. If the claim is unsuccessful, the claimant will not be required to pay any costs to either its legal advisers or the litigation funder.

ATE (after the event) insurance. This is an insurance policy which protects the insured against part or all of the liability it may incur for its opponent’s costs of the litigation. The general position is that, at the end of litigation, the court will order that the losing party should pay the costs of the successful party. Therefore, ATE insurance protects against the risk that the insured loses the litigation and is ordered to pay the other side’s costs.

Contingency fees or damages-based agreements (DBAs). These are not currently permitted in English civil litigation, but that restriction is expected to be lifted following the implementation of the reforms proposed by Lord Justice Jackson by way of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (www.practicallaw.com/2-519-6312).

Under a contingency fee/DBA, a law firm takes a percentage of its client’s damages award or settlement monies as its “fee” in the event of a win or settlement. The Civil Justice Council launched a working party in April 2012 to explore the issues surrounding the proposed introduction of contingency fees/DBAs.

indeed, any claimants) commenced claims under section 90 to date? We consider that there are four key reasons for this, outlined below.

US class action litigation

Until recently, shareholders in the UK may have considered it unnecessary to sue in the English courts if it was possible for them to benefit from class action securities litigation brought in the US against the relevant issuer.

US class actions are generally “opt-out”, which means that members of the putative class of claimants may, without taking any active steps in the proceedings, participate in the proceeds of any court judgment or court-sanctioned settlement, unless they specifically opt-out. Historically, the putative class of claimants in securities claims may have included all holders of the issuer’s shares

regardless of where they acquired the shares or the country in which they lived. This meant that, subject to the US court not dismissing their entitlement on the ground of jurisdiction, UK (and other non-US) shareholders could potentially benefit from US class action litigation without any cost or risk whatsoever.

The class action litigation commenced against RBS in the District Court for the Southern District of New York in 2009, for example, was originally stated to be brought on behalf of all ordinary shareholders who acquired shares within a defined period. The action groups considering claims against RBS in the English courts indicated that they proposed first to wait and see whether their members could benefit from the US litigation.

However, in its 2010 decision in *Morrison v National Australia Bank*, the US

Supreme Court significantly restricted the extraterritorial application of US securities legislation (see *News brief "Foreign-cubed securities actions: the end of the line?"*, www.practicallaw.com/5-502-8826). The US Supreme Court ruled that section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 thereunder, applied only in connection with the sale or purchase of a security listed on a US exchange, or the sale or purchase of any other security in the US. The new test, therefore, focuses on the location of the transaction in question, rather than where the alleged fraud occurred.

As a result of that decision, non-US shareholders are unlikely to be able to participate in US class action securities litigation unless they acquired the relevant securities on a US exchange.

Cost and funding

Large-scale commercial litigation is an expensive undertaking, not least litigation commenced against a listed company seeking a significant sum of money. These costs, which include the risk of paying the issuer's costs if unsuccessful, mean that action groups are unlikely to proceed until they are confident that they have sufficient funds to pursue the claim fully, and that they have in place measures to ensure that their members are adequately protected.

In the first instance, action groups will normally raise funds through charging shareholders to become members; this will typically be a joining fee together with an amount per share held. In order to generate sufficient funds, it is usually vital that an action group attract a necessary number of institutional investors who will principally fund the claim. Without that institutional support, few action groups have been in a position to proceed.

However, in recent years, alternative forms of litigation funding have progressively become available (see box "*Litigation funding*"). An increasing number of law firms are prepared to work under conditional fee agreements (CFAs). The third party litigation funding market has

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also grown exponentially in the last five years and is steadily gaining recognition and acceptance among lawyers and clients alike (see *feature article "Third party funding in international arbitration: balancing benefits and risks"*, www.practicallaw.com/7-519-6946).

The position of third party funders in respect of both section 90 and group claims is not yet clear. Unsurprisingly, third party funders have traditionally been interested only in multi-million pound claims with extremely strong prospects of success. Section 90 claims brought by action groups will almost certainly meet the first of these criteria (one of the RBS actions groups, for example, has indicated that it expects its claim to be in the region of £3 billion). However, the key question is whether action groups (and their legal advisers) are able to convince third party funders that their claims have a strong prospect of success, especially as it may not be possible to give a realistic determination of the merits at an early stage (see "*Evaluation of merits*" below).

Regardless of whether or not third party funding is obtained, action groups are generally careful to ensure that

their members are adequately protected against an adverse costs order in the event that the claim is unsuccessful. Accordingly, action groups will generally seek to secure ATE (after the event) insurance (indeed, this is generally a requirement of third party funders). Again, the position of ATE insurers in respect of claims under section 90 is not yet clear.

We anticipate that the availability of litigation funding to action groups will be the single most important factor in determining the number of claims pursued under section 90.

It will also be interesting to gauge the impact of the reforms proposed by Lord Justice Jackson in this regard when they come into effect (now not expected to be until April 2013). Jackson LJ was generally supportive of third party funding, but proposed that success fees under CFAs and ATE premiums should cease to be recoverable from the other side. However, it is the proposed introduction of contingency fees that could potentially have the most significant and far-reaching impact on claims for collective redress (see box "*Litigation funding*").

Evaluation of merits

It may not always be straightforward to evaluate the merits of a claim under section 90 at an early stage when only limited information is publicly available. It would be rare for a claim to be as simple as “the prospectus said x, whereas the position at the time was clearly known to be y” or “the listing particulars should have included z, but failed to do so”.

Instead, a claim under section 90 is likely to involve the consideration of complex issues such as prevailing industry practice, the knowledge of the issuer and relevant individuals at the time the listing particulars or prospectus was prepared and, perhaps most crucially in relation to claims arising out of the financial crisis, the foreseeability of future events or circumstances.

When considering a claim, a potential claimant may have only limited public information available to him (for

example, the listing particulars or prospectus, and subsequent financial disclosures). A potential claimant may therefore consider seeking pre-action disclosure under CPR 31.16. Although the threshold for ordering pre-action disclosure remains relatively high, we would expect the court to look favourably on an application by a prospective claimant under section 90 made in the right circumstances. It will also often be necessary to instruct experts to assist in the investigation of the claim.

All of this carries with it expense. As outlined above, both shareholders and litigation funders are likely to commit financially to a claim only if they are convinced that it has a good prospect of success. Action groups may therefore find themselves in an invidious position in which they do not have the funds to investigate a claim fully, but cannot easily raise those funds without that investigation.

Impact on the issuer

A shareholder who continues to hold shares in the issuer should also consider the impact on his investment of a claim under section 90.

Subject to any insurance in place, any damages payable by the issuer (and most likely, any director defendants) will have to be paid out of the issuer’s own funds. This gives rise to the risk that the result of a successful claim is simply that Peter has been robbed to pay Paul. Furthermore, litigation can in itself suppress an issuer’s share price. Lengthy and hard-fought litigation may also divert valuable time and resources away from the principal activities of the issuer.

Clearly, these issues are of limited concern to a former shareholder who sold his shares and is seeking to recover his loss.

Jonathan Cary is a senior associate, and Jo Rickard is a partner, at Shearman & Sterling (London) LLP.