THE INSTITUTE OF CHARTERED ACCOUNTANTS
IN ENGLAND AND WALES

Our ref: ICAEW Rep 119/08

Issuer Liability Consultation
Savings and Investment Team
Room 3/20
HM Treasury
1 Horseguards Road
London SW1A 2HQ

By email: issuerliability@hm-treasury.x.gsi.gov.uk

Dear Sirs

ISSUER LIABILITY

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to respond to your request for comments on the *Extension of the Statutory Regime for Issuer Liability,* published in July 2008.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours faithfully

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 119/08

ISSUER LIABILITY

Memorandum of comment submitted in October 2008 by The Institute of Chartered Accountants in England and Wales, in response to HM Treasury's consultation paper *Extension of the Statutory Regime for Issuer Liability*, published in July 2008.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the HM Treasury's consultation paper *Extension of the Statutory Regime for Issuer Liability,* published in July 2008.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

MAJOR POINTS

4. We support the Treasury's careful consideration of these issues, with the proposed reforms taking forward the work done in the Davies Review of Issuer Liability (to which the Institute also responded). Changes to the UK regime of issuer liability were required, upon implementation of the Transparency Directive, and it is appropriate that the extent of the changes should be judged according to general standards of fairness and equity, as well as our requirements under the EU treaties.

5. In deciding the extent to which liability should be extended, it is important to take into account not only the drivers towards absolute consistency in the principle that those who have been caused loss by the reckless or fraudulent behaviour of others should have legal redress in the Courts, but also the dangers of unwarranted increases in vexatious litigation and the availability of regulatory and administrative sanctions, as an alternative to legal redress.

6. The Institute is very aware of the danger that an increase in liability for issuers may reduce their willingness to make public statements without careful consideration and due process, in order to avoid the slightest implication of recklessness. This could reduce the amount of information available to the markets and also its timeliness. In addition, we do not believe that an increase in the climate of litigiousness in the UK would be in the interests of commerce or the economy, and therefore would not be in the interests of the UK as a whole.

7. Nevertheless, we also recognise that provable losses may be experienced by investors, as a result of fraudulent statements by issuers, even in the cases where these will be less obvious. On balance, the Institute has taken the view that it would be preferable to limit the extension of the regime, as set out in the answers to specific questions as set out below, but we are aware that these are not foregone conclusions.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

1. To make no change to the current basis of liability (i.e., fraud).

We support this proposal for the basis of liability to be as for fraud as defined in the tort of deceit, because we consider that intention or recklessness is an appropriate trigger for liability. We believe that issuers should not be liable for civil claims for statements made through negligence, which is better left to the FSA's rules and enforcement powers. In light of recent economic conditions, we believe the FSA should use their powers, where appropriate, to initiate criminal proceedings in cases of 'gross negligence'.

2. That liability should attach in respect of securities admitted to trading on a UK regulated market or a UK multilateral trading facility.

We tentatively support this proposal to extend the regime to exchange-regulated markets, as we agree this will provide their issuers and investors with greater certainty as to investor rights in the event of fraudulent misstatements by issuers. This conclusion has been reached on a tentative basis because the public policy rationale for the regulatory levels and the balance between regulation and liability in the exchange-regulated markets is not clear and we believe require more research. In particular, our answer may differ if the government implements the proposal to extend the regime to include 'dishonest delay' (see our comments at Proposal 8 below).

3. That the statutory liability regime apply to:

- **issuers of all securities admitted to trading on a UK regulated market or multilateral trading facility; and**
- **issuers of securities admitted to trading on an EEA regulated market or multilateral trading facility, where the UK is the home state for the issuer under the Transparency Directive or the issuer has its registered office in the UK.**

We support these proposals (although see the paragraph below). Regarding the first bullet point, we agree the regime should apply to all issuers listed in the UK, not just those incorporated in the UK. See also 2 above for our views regarding the reference to multilateral trading facilities in first bullet point. We also support the proposal in second bullet point, to extend the regime to UK companies listed in other EU countries.

However, we consider the government should go further and also extend the regime to companies admitted to trading in all third countries worldwide in cases where English law is found to apply, rather than restricting it to the EU. If English law is found to be applicable in a particular case, we think that English law including section 90A should be applied, rather than the common law being applied in such circumstances. The proposed statutory regime is a helpful regime and we are of the view that it should be available to all cases where English law is found to be applicable.

4. That the regime apply to:

- **'transferable securities' as defined in section 102A(3) of FSMA;**

- **in the case of depositary receipts and other secondary securities giving a right to acquire or sell other transferable securities, the issuer liable to pay compensation shall be the issuer of the underlying securities, provided that the secondary securities concerned have been admitted to trading by or with its consent;**

- **for depositary receipts and other secondary securities admitted to trading without the consent of the issuer of the underlying securities, and for all other derivative instruments, the issuer of the depositary receipts, other secondary securities or derivative instruments shall be liable to pay compensation under the regime.**

We support this proposal.

5. That the scope of disclosure of the statutory regime should be:

- **all information published by the issuer by means of a recognised information service;**
- **other information where the availability of that information has been announced by the issuer by means of a recognised information service; and**
- **a recognised information service for these purposes will include both RISs and information services used to disseminate information which is required to be published by the rules of an MTF.**

We support this proposal, as there will be many circumstances in which information which is originally given in an ad hoc statement is repeated (identically or possibly repackaged) in periodic statements. We therefore agree that intention or recklessness should be introduced as a basis for liability for ad hoc statements as well as for periodic statements. Also, we note that while the Transparency Directive does not require market protections for ad hoc statements, the Market Abuse Directive might well be interpreted as doing so, leaving a danger that the Courts will interpret the latter as requiring compensation in cases of negligence. This would be inconsistent with the conclusions (which we support) that that the basis for liability should be as for fraud.

Regarding 'out of hours' announcements, we consider that the scope of disclosure within the statutory regime should include 'fall-back' information distribution mechanisms adopted by the regulator of the relevant market or trading platform, for example, notifications made pursuant to DTR 1.3.6 or 2.4.2.

6. That the statutory regime should provide that the proposed immunity does not affect the rights of a holder of securities in his capacity as such.

We support this proposal, meaning that the regime will not apply to prevent liability where a party (e.g. the issuer, or a third party accountant) has expressly accepted responsibility for particular statements. Holders of securities would therefore continue to be able to take action for negligence, through their position as the holders of securities to whom statements are addressed, but not through the new regime of issuer liability.

7. That the issuer be liable, irrespective of whether the person claiming damages obtains the relevant information from a recognised information service, or other source, provided that the information was published on a recognised information service.

We support this proposal.

8. To extend the statutory regime to include liability where the issuer:

- **acts dishonestly in delaying publication of the information;**
- **by the delay intends to enable a gain to be made or to cause loss to another or expose another to the risk of loss.**

On balance, we do not support this proposal. We do not consider that liability for dishonest delay should be introduced, even in the narrower circumstances proposed (i.e. even with the additional objective requirement for the market to consider the delay dishonest). Sanctions are already available through public enforcement actions by the FSA. Furthermore, in the circumstances of serious and intentional dishonesty, further sanctions would be available against individual directors under Section 3 of the Fraud Act (Fraud by failure to disclose information). We consider that this is an area where public enforcement should be adequate on its own (and should be strengthened if this is currently not the case) and that there is insufficient public interest to justify the introduction of new legal uncertainties and other unintended consequences that could result from the extension of civil liability into this context (including the unintended consequences of increasing the chances of disorderly and premature disclosure, especially if the regime is to be extended to ad hoc announcements). We are also concerned about the number of potential claimants. It is for good reason that the courts have been sensitive to ‘floodgates’ arguments when asked to extend common law civil liability into new areas.

Another important consideration is assessment of damages, which we believe should be assessed on the ‘negligence’ basis (see our comments at proposal 12 below). If delay is brought within the regime, it is unlikely that damages could be assessed according to such an assessment of the losses resulting directly from a ‘misstatement’.

9. That liability should attach irrespective of whether the relevant transaction takes place on or off market.

We support this proposal.

10. To extend the regime to include sellers (but not holders) of securities.

We support this proposal. We agree that statutory protection should be extended to the sellers of securities, in the interests of fairness because they have also carried out a market transaction in reliance on the information.

On balance, we agree that statutory protection should not be extended to the holders of securities, which is in line with our general view that changes to the regime should be kept to a minimum to avoid increases in the climate of litigation in the UK, particularly in view of the fact that other actions are available against fraudulent misstatement. The Davies Review clearly articulated the difficulties of establishing the damages which might be assessed against holders of securities who have not undertaken any transaction (particularly where any potential loss or gain has not been crystallised). In addition, continuing shareholders have their own forms of redress.

However, we do recognise that in some cases losses may directly, and provably, be caused to holders of securities, as well as buyers and sellers, which would lead to valid arguments for extension of liability to holders of securities, as a matter of consistency. The decision on this matter should be reached on the basis of balancing the general advantages of avoiding extending a climate of litigiousness, against consistency and fairness to individuals, and we believe any decision not to extend the regime to holders of securities should be kept under review.

11. Not to extend the statutory liability regime to directors and advisers.

We strongly support this proposal. The current regime whereby claims are made against the company and it is the company that makes claims against its directors or advisers, where appropriate, enshrines an important principle of corporate governance in this country. This has worked satisfactorily and should be retained. The company will have an adequate basis for recovering any damages against its directors and advisers on the basis of the decision in *Caparo* (and subsequent refining cases), which we do not believe should be undermined. In the 2005 White Paper that preceded the Companies Bill, the government consulted on the possibility of codifying *Caparo*. Codification of *Caparo*, and all the subsequent decisions that have refined this area of case law, would be fraught with difficulty and so at that time the Government wisely took the public policy decision not to do so, and we are pleased to see that the government are intending to continue this stance.

12. To make no changes to the statutory regime in respect of assessment of damages.

We support this proposal. Damages should continue to be left for the Courts to decide, which means they are likely to be assessed on the 'negligence' basis, in that they should be assessed according to the narrowly judged losses resulting directly from the misstatement, not the wider basis of including losses which may stem from other unconnected occurrences. [Investors in the capital markets are providers of risk capital, and when investing they hope for capital gain but accept the risk of market fluctuations, and that the market can go down as well as up. We believe it would be inappropriate to apply the 'deceit' measure of damages, as this will lead to some investors obtaining direct recompense for market fluctuations that by coincidence happen to coincide with a false statement being issued to the market.]

13. To consider further the issue of subordination of investors' claims.

We agree that this issue should be further considered, and would welcome the opportunity to discuss this with you.

We consider that the claims of investors should be subordinated to those of unsecured creditors. Though the company may have been equally or more at fault in its relations with investors than with other creditors, investors in the capital markets are generally providers of risk capital and are in a good position to manage their risks by diversification or a range of other techniques. This may not be true of unsecured creditors who will frequently be trade creditors. Damage to local or regional economic conditions could be unnecessarily aggravated, if the insolvency of a company is followed by consequent damage to its local or regional suppliers and other unsecured creditors.

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