The Relevance Of Time In Framing the Sanctions Framework for Defective Disclosure

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Abstract

Sanctions imposed on listed companies in cases of breached disclosure obligations have steadily but rather slowly been moving towards a harmonized approach in EU corporate law. Without compromising the potential efficiency of these harmonisation measures, this article aims to propose an alternative method to increase the efficiency of sanctions. By focusing on the importance of time as an element that influences corporate decisions in relation to the breach of disclosure obligations, this article seeks to re-frame the importance of sanctions and to link their severity to time manipulation strategies that are potentially adopted by listed companies. This study argues that by linking sanctions and time, the legal framework would be likely to apply more severe sanctions, while adopting differentiated sanctions depending on which disclosure obligations are breached. This new approach aims to trigger a de facto harmonisation trend amongst regulators and judges at the national and EU levels.

1. Introduction

Monitoring and sanctioning defective disclosure strategies, such as the disclosure of incorrect information or the omission of correct information, are matters of pivotal importance to the efficient functioning of capital markets. Although monitoring by engaged governance actors, such as shareholders and other gatekeepers, based on the exercise of rights within the company, may prove to be less costly than formal regulatory strategies, which traditionally involve courts and regulators,[1] it is equally important to secure the efficiency of the latter mechanisms in the case of corporate breaches of applicable rules. Nevertheless, the imposition of sanctions in the area of capital markets law and, more specifically, in the field of disclosure obligations

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[1] John Armour, Henry Hansmann and Reinier Kraakman, *Agency Problems, Legal Strategies, and Enforcement* (2009) ECGI - Law Working Paper No. 135/2009, http://ssrn.com/abstract=1436555 (accessed 15 May 2015).

applicable to listed companies, has proven to be a particularly complex task. Historically, legislation in various countries has treated the breach of disclosure obligations differently, undoubtedly reflecting countries' cultural and legal traditions related, amongst other elements, to the political willingness to tackle efficiently illegal behaviour, the regulators' sophistication with regard to deciphering complex market practices and to regulatory capture issues.

The creation of the EU internal market and the risks associated with illegal practices have triggered a series of initiatives aimed at harmonising sanction measures at the EU level.[2] The Prospectus, Transparency and Market Abuse Directives have dealt repeatedly with sanctions applicable to the breach of disclosure obligations for prospectus, periodic and episodic disclosure obligations. Overall, these initiatives show some accomplishments. For example, an understanding has gradually emerged that disclosure obligation breaches must be sanctioned with equal severity at the EU level. Nevertheless, considerable differences still remain at the national level, creating discrepancies between national laws and opening space for regulatory competition. As we will see in this article, sanctions in various legal systems have failed to demonstrate their effectiveness in terms of enforcement and dissuasion, either because the applicable framework is not stringent enough or because its implementation lacks in consistency, frequency and rigour.

Disclosure obligations have traditionally been used in EU law as a means to ensuring market efficiency, enhancing investor confidence and reducing agency costs.[3] If the ultimate goal is to secure and strengthen the viability of the EU internal market against illegal practices that can harm its reputation and credibility, the applicable legal framework needs to be further harmonised. Nevertheless, linking disclosure policies and the consequent strengthening of sanctions exclusively to market efficiency objectives may not suffice to provide a clear rationale for further harmonisation trends due to concerns over the 'chilling' effect of strong sanctions on the flow of information to the market. Thus, this article aims to view disclosure

[2] Our article aspires to propose an alternative model for the establishment of a more sophisticated enforcement system with potential implications at both the EU and international levels. It explicitly focuses on EU law and the perspectives of adoption of a series of proposals in order to create a convincing example that may then be adopted on other continents. The choice of the EU framework is based on its unique diversity, rooted in various legal traditions, and the ongoing efforts to built a common perception of the necessity for optimal sanctions.

[3] For a comprehensive analysis of disclosure policy rationales and drawbacks, *see* Luca Enriques and Sergio Gilotta, *Disclosure and Financial Market Regulation*, in *The Oxford Handbook on Financial Regulation*, 511 (Oxford; Oxford University Press, 2015).

requirements – and the subsequent argument for stronger sanctions in cases where they are breached – as a form of accountability in addition to their role in ensuring market efficiency. Listed companies and natural persons involved in disclosure strategies need to be held accountable for their choices; disclosure obligations aim to make these strategies visible and subject to market actors' evaluation while reducing informational asymmetry.[4] If this additional accountability function is to become convincing and to be preserved in the regulatory agenda, sanction frameworks must be strengthened and constitute a dissuasive counterbalance argument against deficient corporate strategies.

While acknowledging the limitations of further harmonisation[5] in the area of sanctions that has traditionally been regarded as part of national legal and political landscapes,[6] this study aims to put forth an alternative harmonisation method that will operate not only on a *de jure*, but also on a *de facto* basis. We believe that this alternative harmonisation trend will be better suited and much more adaptable to various national legal frameworks due to its flexibility and non-interference with potential reforms of national laws in this area. By not obliging EU Member States to reform their current legal provisions in depth, the alternative proposals are much more likely to be acceptable at the national level and to be implemented in a less complicated way. The core concept of our proposal does not deal with the harmonisation of national legal sanctioning provisions but with the harmonisation of the calculation of the sanction itself that can be imposed by the national competent authorities or by the courts. By introducing the element of time manipulation into the calculation of sanctions and by triggering specific 'aggravating circumstances', national authorities and judges will have the discretion to increase the sanction imposed regardless of the applicable legal framework. Our article thus seeks to accentuate the 'law in action' facet of capital markets law, rather than the 'law in books' one.[7] An attempt to harmonise the calculation of sanctions indirectly by

[4] On the notion of information asymmetry, *see* Robert C. Merton, *A Simple Model of Capital-Market Equilibrium with Incomplete Information* 42 Journal of Finance 483 (1987).
[5] More generally on these limitations, *see* Kathryn Cearns and Eilís Ferran, *Non-Enforcement Led Public Oversight of Financial and Corporate Governance Disclosures and of Auditors* 8 Journal of Corporate Law Studies 191, 193 (2008).
[6] More specifically, on matters related to variable regulatory intensity across different jurisdictions, *see* Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications* 24(2) Yale Journal on Regulation 253, 286 (2007).
[7] On these concepts, *see* Roscoe Pound's seminal work, *Law in Books and Law in Action* 44 American Law Review 12 (1910).

introducing 'aggravating circumstances' first requires such circumstances to be defined, along with a common mindset to be reached regarding the appropriateness of such a goal. We believe that this alternative harmonisation method will trigger gradual commitment to more severe sanctions for disclosure obligations breaches by listed companies.

This proposal could therefore fit within the wider EU regulatory agenda for promoting financial stability and supervisory convergence, as was recently elaborated in the Capital Markets Union Action Plan.[8] The European Securities and Markets Authority (hereinafter ESMA) is expected to assume a much more active role in strengthening supervisory convergence, while ensuring the effectiveness of supervisory mechanisms and comparable outcomes at the EU level. Our proposals for more targeted sanctions and alternative harmonisation methods serve these objectives and can be seen as an example of gradual convergence in the area of sanctions which will contribute to the integration of EU capital markets and the enhancement of accountability of various market actors.

As an overarching concept, our proposal for convergence in the law in action, namely in the sanctions imposed for a violation of the relevant disclosure obligations, is based on the conviction that it is the necessary tool to ensure equal levels of investor protection and a level playing field between listed companies, as well as to gradually eliminate regulatory arbitrage in the sanctions area. This approach can be considered in the light of other mechanisms that may be present in various jurisdictions, such as institutional or market features (for example, regulatory quality, lack of political pressures, sufficient enforcement resources and strong shareholder activism) that may lessen the importance of relying on sanctions. This could be particularly true if these alternative features can ensure greater compliance with disclosure obligations and hence render ex post enforcement mechanisms less urgent. But even if other approaches are relevant, it is our belief that sanctions are ultimately the most efficient means to secure the above-mentioned goals, even in the presence of some of the above mentioned alternative factors that may be solidly enshrined in some countries' cultural or market traditions. Convergence in the area of enforcement

[8] Commission, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan on Building a Capital Markets Union* COM(2015) 468 final, Brussels, 30 September 2015, 26 http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf (accessed 9 October 2015).

strategies is not only a matter of a hypothetical need to prevent potential violations from having harmful effects on capital markets in jurisdictions where companies have traditionally shown high levels of compliance. It is also a matter of securing capital markets from regulatory arbitrage, variably rigorous legal frameworks and, last but not least, ensuring investor protection also via efficient and converged sanctions across the EU (even in the presence of the other investor protection mechanisms in some Member States).

Section 2 of this article will present the theoretical framework upon which a new theory can be built, linking the element of time manipulation with the imposition of sanctions against deficient practices in order to achieve an optimal level of enforcement. Section 3 will deal with the current *de jure* harmonisation trends at the EU level in the area of sanctions for disclosure obligation breaches in the Prospectus, Transparency and Market Abuse Directives and Regulations. This Section will aim to show the limitations in the area of sanctions at the national and EU levels, and will examine the feasibility of further harmonisation with regard to the current EU framework. Section 4 will deal with an alternative and experimental proposal for the introduction of more targeted sanctions via a *de facto* harmonisation framework. This framework will allow Member States to increase the severity of sanctions by introducing 'aggravating disclosure circumstances', namely the fact that the disclosure or omission of information took place in a specific time framework adjacent to either a prospectus, periodic or episodic framework. The analysis will also focus on the practical limitations that will most probably continue to exist at the national level and will aim to highlight the difficulties that the proposed sanctions scheme may face. The article will conclude (Section 5) by emphasising the need to create more targeted and responsive sanctions to corporate disclosure strategies.

2. The Invisible Relationship between Time and Sanctions

The recurrent observation regarding sanctions in the area of disclosure obligations is that they are still largely divergent, have a more or less important role depending on the national framework or, in some cases, they have been subject to minimum harmonisation attempts, albeit without showing signs of convergence at the EU level. Moreover, the general availability of civil liability as well as criminal and

administrative sanctions for all types of breaches is undoubtedly a good step towards efficiently tackling illegal practices since the various types of sanctions can be imposed for different purposes, such as compensation, deterrence, dissuasion, etc.[9] Nevertheless, we firmly believe that the mere general availability of these sanctions for all types of breaches is not necessarily the optimal approach to sanctioning breaches in this area as their responsiveness to illegality bears a very generic connotation and does not target some important elements of the defective disclosure strategies.[10]

Indeed, our article attempts to frame, at a theoretical level, the question of whether time is relevant to disclosure strategies and, in the affirmative case, whether this assumption should influence the shaping of a new sanctions framework. It therefore attempts to question the idea that the breach of disclosure obligations is based, *inter alia*, on the choice of the adequate moment in time for the disclosure (or omission of disclosure) of information. In fact, it can be argued – at least in theory and in the absence of empirical studies which would need to be carried out in the future – that any informational practice that violates the applicable framework is associated with a meticulous strategy with regard to choosing the moment in time when this practice is supposed to take place according to the respective legal requirements. If companies take into consideration time elements when they are about to violate legal rules, we believe that the law itself should adapt to these time-based

[9] Although various authors have opined in different ways on the importance and the usefulness of various types of sanctions. On the one hand, there is the doctrinal trend which favours the efficiency of 'private enforcement', based on the argument that private parties–in our case, harmed investors–have more incentives to bring a civil claim against non-compliant strategies: Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, *What Works in Securities Laws?* 61 Journal of Finance 1 (2006). On the other hand, a more holistic conception of sanctions and other mechanisms has been advanced, which can secure the protection of capital markets from defective strategies, namely that public enforcement as well as gatekeepers have an important role to play, and which should be–in our view–preferred: Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets* 48 UCLA Law Review 781 (2001). *See* also Howell E. Jackson and Mark J. Roe, *Public and Private Enforcement of Securities Law: Resource-Based Evidence* 93 Journal of Financial Economics 207, 238 (2009), who argue that 'public enforcement is no less valuable for financial market outcomes than private enforcement such as disclosure and, given the weak results for private enforcement's liability measure, perhaps liability is less important'. On the coexistence and the distinctive features of private and public enforcement, *see* Guido A. Ferrarini and Paolo Giudici, *Financial Scandals and the Role of Private Enforcement: the Parmalat Case* ECGI - Law Working Paper No. 40/2005, 42 (2005) http://ssrn.com/abstract=730403 (accessed 15 May 2015).

[10] Moreover, choosing an appropriate sanction that is commensurate with and efficiently targeted to the distinctive features of each rule-breaking incident can prove to be quite an arduous task. This is not only due to the particulars of each reprehensible behaviour, which inevitably vary, but also to the different symbolic connotations that each type of sanction conveys. For an interesting discussion of the range of sanctions, *see* Iain MacNeil, *Enforcement and Sanctioning*, in *The Oxford Handbook on Financial Regulation*, 280 (Oxford; Oxford University Press, 2015).

strategies by creating a parallel framework constructed upon time manipulation considerations. Therefore, legal provisions should counterbalance the calculations made by companies with regard to the use of time in their disclosure strategies. A new approach to sanctions could then legitimately be envisaged, at least at a first and inherently tentative level, in order to advance the policy discussion around the opportunity to develop alternative ways to make sanction frameworks more efficient.

The rhythm of disclosure varies according to the prospectus, periodic and episodic frameworks. Market expectations and the need for information disclosure vary depending on the context of the chosen moment in time for such disclosure to take place, inevitably creating various motives and tendencies for companies, which may be tempted to violate the informational transparency principle.[11] By examining the three above-mentioned informational frameworks and the informational tendency that they can create for companies, we can illustrate this assumption in a rather straightforward way.

To start with prospectus disclosure obligations, mostly in the case where a company decides to list its shares for the first time (and much less when it is simply issuing further shares to raise more capital), investors will inevitably be more interested in all sorts of information regarding the company's prospective financial performance, even though the prospectus will contain a sufficient amount of historic/periodic information. The reason for the increased interest in prospective information in this framework is that investors are faced with an IPO that constitutes a new investment perspective (and this would not of course be the case in the listing of additional shares where the listed company's profile is already known to the investor community) and investors can only rely upon the prospective profits obtained rather than upon the historic information with regard to the company's profile. Although this amount of historic information will play a role in winning investors' confidence with regard to the viability and profitability of the listing, the IPO or the listing of

[11] Our study touches upon both fraudulent and negligent breaches of disclosure obligations: companies may indeed calculate with extreme sophistication the cost of any informational breach or just decide to remain relatively apathetic to a costly ongoing monitoring of the informational veracity in their internal structure. The accentuation of sanctions, as it will be developed in this article, is based at times only upon the proof of fraud (*see* the prospectus and periodic obligations *infra*, Sections 4.2*(a)* and 4.2*(b)*) but is proposed both for fraud and recklessness in episodic obligations (*see infra*, Section 4.2*(c)*). This choice is based on the fact that the enhancement of different types of sanctions might not be entirely justified in recklessness cases, as it would result in increased liability levels without the necessary underlying rational and the improvement of corporate strategies. Incompetence is indeed a common phenomenon that should not–in our view–trigger in all cases and automatically the enhancement of sanctions imposed.

additional shares will inevitably appeal to investors mostly thanks to their innovatory element being a 'new' investment project associated with prospective profit expectations.

Investor expectations tend to be slightly different in periodic disclosure obligations since the predominant element in their decision-making is the need to observe the regularity, veracity and maintenance of management policies with regard to the company's progress, as it is translated via the information disclosed at specific moments in time. Moreover, investors in this framework will inevitably show a greater appetite for frequently disclosed information, which puts greater pressure on management and accentuates short-termism at a larger scale.[12] It is therefore much more likely for investors to expect (with impatience) the maintenance of previously-announced targets, while noting continuity in the corporate management practices and pressuring management for more frequently disclosed reports, which reassures them that their investment in a specific company continues to have a reasonable justification.

Turning towards episodic disclosure obligations, arising at any time when the legal framework triggers such an obligation, it would be reasonable to argue that both companies and investors are mostly focused on an even more accentuated short-term mentality as far as the disclosure and use of this information is concerned. This is particularly plausible if we take into consideration the fact that both parties are seeking to maintain or amend their relationship following the occurrence of a piece of news disclosed at any moment in time.

[12] In order to address the ever-growing problem of short-termism, more recently there have been some efforts to channel investor expectations into a longer-term perspective with the reduction of the rhythm of disclosure of periodic reports, the most notable example being the lifting of the requirement to publish interim management statements or quarterly reports for listed companies in the revised Transparency Directive: Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading, and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC [2013] OJ L294/13 (Transparency Directive). Moreover, although the lifting of this requirement does not prevent companies from disclosing such reports, it is encouraging to observe that UK listed companies have followed a longer-term disclosure trend by moving away from quarterly reporting. This effort is *inter alia* related to the Stewardship Code that seeks, albeit with the adoption of methods of questionable efficiency, to enhance the quality of engagement between institutional investors and investee companies. More generally on the Stewardship Code, *see* Brian R. Cheffins, *The Stewardship Code's Achilles' Heel* University of Cambridge Faculty of Law Research Paper No. 28/2011 (2011) http://ssrn.com/abstract=1837344 (accessed 10 May 2015); Arad Reisberg, *The UK Stewardship Code: on the Road to Nowhere?* 15(2) Journal of Corporate Law Studies 217 (2015).

On the one hand, companies need to disclose information in this specific framework by using any moment in time in order to announce a positive piece of news, expecting to preserve – and widen – their shareholder base. Investors, on the other hand, are interested in any unexpected information since they will either maintain their shareholder status – or invest more – in a company following positive news flow or exit the company when the news is negative. All parties involved in this process will inevitably react to any news released unexpectedly. Therefore, the potential manipulation of the information becomes much more eminent. In fact, companies may wish to disclose information on their websites or via an interview with the financial press, knowing in advance that this will inevitably influence the share price by triggering an immediate reaction from the investor community.

As a result, the episodic disclosure framework is also subject to strategies aimed at choosing the right moment to trigger the desired reaction from the investor community. If companies know in advance that the news is accurate and very positive, they will seek to disclose it when it best serves the purpose of attracting as much more capital as possible.[13] Nevertheless, if they know that the news is negative and they are attempting to disclose a wrongful information in order to make it appear positive, their strategy will be aimed at obtaining the best benefit from the market's reaction based on the short-term criterion of the effect of the disclosure itself. Moreover, we must bear in mind that breaches of episodic disclosure obligations can generate profits in a very short-term – quasi instantaneous – framework, and the motives for such a breach must be sufficiently dissuaded.[14] Adding further to this complexity of corporate strategies, we must remember that, contrary to prospectus

[13] Most importantly, it should also be mentioned that corporate managers operate under constant pressure to generate positive news to continue to raise the company's share price. Companies are thus compelled to keep on showing a positive profile for current and prospective investors. This situation can certainly create extra motives for the manipulation of data or the information disclosed. The overall 'dependence of markets on constant company-relevant data streams as a basis for stock allocation decisions and associated professional communications' has been described as an 'informational centricity' phenomenon that creates a 'compelling pressure on corporate managers to generate fresh "news" indicative of perceived business "progress", in an effort to influence future share price movements': Marc Moore and Edward Walker-Arnott, *A Fresh Look at Stock Market Short-Termism* 41(3) Journal of Law and Society 416 (2014).

[14] Profits in this scenario would be channeled to the potential buyers or sellers engaged in market activities during the period in which disclosure failures have taken place. More generally, companies would benefit less directly in this scenario, merely by triggering an increase in the share price but not by gaining in a straightforward way (as would have been the case had they issued new shares privately at a higher price than could have been achieved with full episodic disclosure). That said, it is also important to note that deficient disclosure strategies in the episodic framework are also likely to affect periodic disclosure strategies more generally.

disclosure obligations, which occur at a much less frequent pace, periodic and episodic obligations are recurrent and can thus be subject to much more defective disclosure incidents.[15]

It is therefore necessary for the legal framework to start taking into consideration the time element that is presumably manipulated by companies when they disclose information in different frameworks, as mentioned above. By acknowledging that time is relevant with regard to the rhythm of disclosure of information regarding the company, legal rules will be able to shape a more responsive framework to these time-oriented strategies and hence start constraining companies to avoid manipulating time itself when they violate disclosure obligations. The current framework neglects the fact that each breach is committed following a rational choice that compares the eventual consequences (i.e. possible sanctions) against the potential advantages that such a time-based strategy can have for the company itself. With regard to achieving an optimal balance ahead of a disclosure obligation breach, it is very likely that a company will not heed the potential threat of sanctions in this area because the current system does not target specific corporate strategies per se, but adopts a rather generic approach without distinguishing between different types of disclosure frameworks and offering a general variety of sanctions.

Therefore, a sanctions framework is needed that targets not only a breach but also the company's underlying motives, along with its efforts to balance the costs and benefits of such a strategy in advance. Such a framework would increase the dissuasive force of sanctions and make it cumbersome for a company to exploit different moments in time when breaching a disclosure obligation. This objective can achieved by accentuating a variety of sanctions that are potentially unpredictable with regard to the quantum imposed,[16] while respecting the principle of proportionality of sanctions. This will become feasible via the calculation of sanctions based on a series of specific 'aggravating disclosure circumstances', potentially triggering higher

[15] '[U]nlike prospectuses, which are required only sporadically in an issuer's life, periodic and episodic disclosures have to be made frequently, implying that there is more opportunity for mistakes to be made. Internal controls and due diligence procedures governing periodic and episodic disclosures may not be as robust as in relation to prospectuses, and public oversight in the form of FSA [now FCA] vetting before publication does not apply': Eilís Ferran, *Are US-style Investor Suits Coming to the UK?* 9 Journal of Corporate Law Studies 315, 320 (2009).

[16] To seek to neutralise *a priori* 'cost-benefit' calculations made by companies and other persons with regard to disclosure breaches. As it has been wisely stated, 'Some people become "criminals" not because their basic motivation differs from that of other persons, but because their benefits and costs differ': Gary Becker, *Crime and Punishment: an Economic Analysis* 78(2) Journal of Political Economy 169, 176 (1968).

sanctions which will be analysed in detail in Section 4.[17] The next section will focus on the current sanctions framework at the EU level to highlight the need for the adoption of our proposal as an alternative means for a better enforcement system.

3. The *De Jure* Harmonisation of Sanctions at the EU Level

3.1 *Prospectus Disclosure Obligations*

Prospectus disclosure obligations were first laid out in 2003 via the Prospectus Directive[18] that served as the first EU framework for the harmonisation of rules applicable to issuers aiming to attract capital market investment. However, the EU's priority was not harmonisation per se, but rather the simplification and increased competitiveness of EU capital markets that could be ensured by creating a uniform informational framework. Bearing in mind that the driving force behind the Prospectus Directive was to simplify capital issues and encourage capital market investment across borders, through identical informational requirements allowing comparability and accessibility from the investor community,[19] the EU policy agenda inevitably focused on accelerating the harmonisation of informational requirements. This aim was indeed obvious given the maximum harmonisation level provided in the Directive.

Nevertheless, other parts of the Directive, such as the area of sanctions, were largely left up to the Member States to decide the optimal framework in order to provide investor protection with regard to disclosure obligation breaches.[20] This

[17] The accentuation of sanctions is by no means a way to disregard the undoubted benefits of reinforcing preventive measures in this area and endeavouring to increase the transparency of other market actors, such as high-frequency traders, whose practices also trigger a series of concerns in capital markets. Therefore, issuers should not be seen as the only entities responsible for market instability due to deficient practices. Notwithstanding this observation, we believe it to be essential to transform sanctions into 'smarter' and 'more targeted' tools as they currently perform a rather generic role.

[18] Directive 2003/71/EC of the European Parliament and 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 [2003] OJ L345/64.

[19] Mirella Pellegrini, *Critical Analysis of the Prospectus Directive* 17 European Business Law Review 1679, 1681 (2006).

[20] More generally, this regulatory choice is in line with broader EU financial regulation policy. Nonetheless, ESMA has developed an active role in the coordination of enforcement with regard to IFRS disclosures by organising the European Enforcers Coordination Sessions (EECS), where enforcers participate in a forum that aims to provide a framework for sharing and comparing various practical experiences in this area: http://www.esma.europa.eu/page/IFRS-Enforcement-0 (accessed 1 September 2015). This is undoubtedly useful for the gradual preparation of regulatory convergence in

striking difference between maximum harmonisation of informational requirements and flexibility on sanctions imposed at the national level was undoubtedly due to the realisation that progress could not realistically be achieved at all levels from the beginning of the Directive. Facilitating access to capital and creating truly integrated EU capital markets was a matter of pivotal importance and sanctions should be – at that time – left mostly under national frameworks to delineate their scope, especially taking into consideration the very strict time limits.[21]

The sanctions that can be imposed for prospectus disclosure obligation breaches are civil liability as well as criminal and administrative sanctions. Under a very general provision and

> [w]ithout prejudice to the right … to impose criminal sanctions and … to their civil liability regime, Member States shall ensure, in conformity with their national law, that the appropriate administrative measures can be taken or administrative sanctions be imposed against the persons responsible, where the provisions adopted in the implementation of this Directive have not been complied with. Member States shall ensure that these measures are effective, proportionate and dissuasive.[22]

The Prospectus Directive, cautious of the very sensitive and traditionally different civil and criminal liability regimes across the EU, thus tried to accentuate the importance of administrative measures and sanctions as a more feasible way to combat prospectus disclosure obligation breaches. By doing so, it requires the satisfaction of effectiveness, proportionality and dissuasion, three notions that can be subject to various interpretations depending on the idiosyncrasies of national frameworks as well as the size of the various capital markets that issuers have decided to access. This study will aim to look briefly at the problems arising from the lack of sanction harmonisation.

Beginning with civil liability, Article 6 of the Prospectus Directive provides for a minimum harmonisation framework limited to identifying the persons

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the area of enforcement of deficient disclosure practices and testifies to a cultural change with regard to the use of indirect harmonisation measures that may prove useful in the presence of persistent national divergent frameworks.

[21] Pierre Schammo, *EU Prospectus Law: New Perspectives on Regulatory Competition in Securities Markets*, 243 (Cambridge; Cambridge University Press, 2011).

[22] *Ibid*., Art. 25.

responsible for the information contained in a prospectus. Member States are required to ensure that this responsibility covers, at least, 'the issuer, or its administrative, management or supervisory bodies, the offeror, the person asking for the admission to trading on a regulated market or the guarantor, as the case may be.'[23] The above-mentioned persons must clearly be identified in the prospectus and must also declare that, to the best of their knowledge, the information included therein is in accordance with the facts insofar as no omission has taken place which may affect its meaning.

Article 6(2) further specifies that the prospectus summary itself should not trigger any civil liability unless it is of a misleading, inaccurate or inconsistent character, or it does not provide key information to assist investors in their decision, when read together with the other components of a prospectus. The summary must also include a clear warning with regard to this matter,[24] as well as a mention that it should only be read as an introduction to the prospectus and that any investment decision should be based on the prospectus as a whole,[25] aiming to avoid any over-reliance by investors as well as an efficient defence mechanism for issuers against litigation claims. Indeed, it would appear rather difficult for an investor to file suit against an issuer using a summary containing general, fairly vague, information; the issuer could defend its disclosure strategy by invoking the introductory character of the summary.[26]

It would therefore come as no surprise if national courts applied this framework in different ways, depending on their legal traditions, and resulting in different levels of investor protection across the EU. The persistent uncertainty

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[23] Art. 6(1), Prospectus Directive. The minimum harmonisation on this issue can create further discrepancies amongst national laws due to the series of actors participating in the preparation of prospectuses and who may be exempted from liability in some jurisdictions but potentially liable in others.

[24] *Ibid.*, Art. 6(2).

[25] *Ibid.*, Art. 5(2a and b).

[26] Academic commentators have already criticised this vague area, which can serve for various interpretative methods, by insisting on the fact that investors will not always be in a position to demonstrate negligence on behalf of the issuer, especially when the main prospectus is written in another language, taking into consideration that they are expected according to Art. 5(2b) to read the prospectus in its entirety. Issuers would thus be protected against litigation in an operating framework with long prospectuses drafted in another language, including various financial terms and complicated concepts that might also be interpreted in various ways by investors across different countries: Brigit Breslin and Daniel Rabinowitz, *The Prospectus Directive* 9 Journal of Financial Services Marketing 1 (2004). Nevertheless, *see* other academic views mentioning the considerable risks arising from issuer exposure to different liability regimes across the EU due to the lack of a passport system in the area of civil liability: Eilís Ferran, *Cross-Border Offers of Securities in the EU* 4 European Company and Financial Law Review 470 (2007); Luca Enriques and Matteo Gatti, *Is there a Uniform EU Securities Law after the Financial Services Action Plan?* 14(1) Stanford Journal of Law, Business, and Finance 43, 56 (2008).

around this issue and, more generally, around the fact that civil liability regimes are quite different in various jurisdictions clearly does not favour the creation of an rigorous accountability framework for issuers, as the risks of liability arbitrage amongst different jurisdictions will certainly continue to play a major role for issuers when choosing capital markets for seeking financing in the EU. In addition to these concerns, the uncertainty over the governing law for civil liability and the consequent liability exposure related risks must not be neglected either.[27]

To highlight the deficiencies of the current EU civil liability framework, we can divide Member States into two broad categories, with the first developing national frameworks aimed at facilitating investor claims, and the second adopting a much more conservative approach, making successful claims in this area very difficult. Although the various components of national legal provisions on civil liability are not the subject of this article, various comparative analyses have continuously illustrated the considerable divergence amongst national frameworks and the subsequent risks to accountability in prospectus obligations.[28]

Discrepancies are also notable in criminal sanctions, where some national frameworks provide, at least in theory, a very rigorous framework, the most characteristic examples being those of English,[29] German[30] and French[31] law. Regardless of variations in the duration of imprisonment or the amount of potential fines, the common problem with criminal sanctions lies with the high level of proof required, which makes them quite rare and confers quasi immunity to criminal liability for those involved in prospectus disclosure obligation breaches. The above-mentioned rigour in some jurisdictions is thus observed only 'in the books' and not 'in action', which raises questions on the marginalisation of symbolically potent sanctions in this area.

Administrative sanctions seem to be at the centre of the Prospectus Directive since they are required from Article 25, as analysed above, in order to satisfy the

[27] Ferran, *ibid*. 22.
[28] *See*, for example, Rüdiger Veil (ed.), *European Capital Markets Law*, 237 (Oxford; Hart Publishing, 2013).
[29] Sections 89 and 92 of the Financial Services Act 2012, providing for a maximum of 7 years of imprisonment or a fine, or both.
[30] Various general provisions can potentially be used with regard to incorrect information, incorrect description or embezzlement, but the 3 years of imprisonment in the case of fraud, provided in § 263 of the *Strafgesetzbuch*, are most characteristic.
[31] Arts. L.465-1 and L. 465-2 alinéa 2 *Code monétaire et financier*, provide for 2 years of imprisonment and €1.5M. The fine can be increased to a maximum of twice the amount of profits eventually made, if they are higher than this maximum.

criteria of efficiency, proportionality and dissuasion. Unfortunately, while these sanctions are required to satisfy the criteria, the divergence in their severity is striking. Some Member States have opted for highly dissuasive penalties, such as France[32] and the UK.[33] Other Member States have less rigorous frameworks, with maximum penalties going up to €10,000 for natural persons or €100,000 for legal persons in Finland,[34]or up to €500,000 in Italy.[35]

Regardless of the variety of maximum penalties in different jurisdictions, the even more problematic issue related to administrative sanctions is the rarity of proceedings with the exception of some national competent authorities, such as France's AMF that has imposed dissuasive penalties in this area on several occasions.[36] What we can deduce with certainty given the divergence of penalties and the infrequent proceedings in different jurisdictions is the further need for harmonisation as well as further convergence efforts amongst Member States and their authorities with regard to the conception and implementation of the criteria of effectiveness, proportionality and dissuasion.

Aiming to align the Prospectus regime with the Transparency and Market Abuse ones, a new Proposal for a Prospectus Regulation[37] made a rather modest step towards the harmonisation of administrative sanctions by recognising a series of sanctions that NCAs may impose. These sanctions include administrative sanctions and measures, as well as minimum pecuniary sanctions frameworks. NCAs have the power to issue a public statement indicating the nature of the infringement as well as the identity of the person concerned, to publish an order requiring the concerned persons to cease the conduct constituting an infringement, and to impose maximum administrative pecuniary sanctions of at least twice the amount of the profits gained or losses avoided due to the infringement. More specifically for pecuniary sanctions, they can impose maximum sanctions of at least €5 million for legal persons (or at

[32] Art. L. 621-15 II and III *Code monétaire et financier* provides for a maximum of €100M or double the amount of profits eventually made.
[33] Section 91(1A) FSMA does not provide for a maximum fine, thus making it highly dissuasive, at least in theory, for issuers.
[34] ESMA Annex III, 72.
[35] *Ibid*. 148.
[36] For some interesting examples, *see* Konstantinos Sergakis, *La Transparence des Sociétés Cotées en Droit Européen*, 138 (Paris; IRJS Éditions 2013).
[37] Proposal for a regulation of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading, Brussels, 1 December 2015, 2015/0268 (COD). This new Prospectus Regulation will replace the Directive 2003/71/EC, the implementing Regulation No 809/2004 and the amending Directive 2010/73/EU.

least 3% of the total annual turnover of that legal person) and €700,000 for natural persons.[38] Member States may provide for additional sanctions or measures, or for higher levels of administrative fines.[39]

Therefore, in accordance with the Transparency and Market Abuse frameworks, this rather modest initiative constitutes a preliminary attempt to show a tendency of what sanctioning frameworks could look like at the national level, without resolving the key issue of efficient EU-level sanctions of violations in the prospectus area while achieving consistency amongst regulators. The consistency and convergence objectives are dealt with – to a certain extent – by the Prospectus Regulation Proposal. This Regulation Proposal requires NCAs to take into account certain circumstances when determining the type and level of administrative sanctions and measures. These circumstances refer to the gravity and the duration of infringement, the degree of responsibility and the financial strength of the person subject to the sanction or measure, the impact of the infringement on retail investors' interests, the magnitude of the profits gained or losses avoided, the degree of cooperation of the concerned person with the NCA, previous infringements by that person, and the measures taken after the infringement by the person to prevent recurrence of such infringement.[40] This requirement is undoubtedly a useful driver for an indirect harmonisation trend that may occur through gradual convergence amongst NCAs in this area, functioning with the same rationales, notwithstanding the persistent minimum and maximum levels of pecuniary sanctions as previously mentioned.

All decisions imposing sanctions or measures shall be published by NCAs by disclosing the type and nature of infringement, as well as the identity of the responsible persons.[41] This disclosure strategy for the publication of sanctions acts as a 'name and shame' exercise that may prove to be particularly dissuasive in the area of prospectus-related infringements in order to readjust the attractiveness of an investment opportunity and inform the public of a violation. Nevertheless, the Prospectus Regulation Proposal also provides exemptions from such publication in cases that may justify a delay in the publication, an anonymous publication or even a complete absence of publication so as to protect the stability of financial markets

[38] *Ibid.*, Art. 36(2).
[39] *Ibid.*, Art. 36(3).
[40] *Ibid.*, Art. 37.
[41] *Ibid.*, Art. 40(1).

(which could be at risk from such a publication) or to maintain the proportionality of the publication of the measures taken for minor violations.[42]

3.2 *Periodic Disclosure Obligations*

Periodic disclosure obligations are provided by the Transparency Directive[43] and cover annual and half-yearly reports.[44] The sanctions applicable are of a civil, criminal and administrative nature for any breach in these disclosure obligations.

The Transparency Directive attempted to enhance the accountability of a series of market actors operating within issuers by stipulating that they must include statements in annual[45] and half-yearly reports[46] by clearly indicating their names and functions and by stating that the information contained in these reports gives a true and fair view of the issuer's position and other components of its business. The clear identification of responsible persons for periodic information conveys, in theory, the message of forcing potentially liable persons to adopt more prudent strategies as their exposure is increased. Nevertheless, the Transparency Directive does not provide any details as to the identity of the responsible persons within the issuer, and thus the choice of these people as well as their inclusion in the statements will ultimately depend on listed companies. Adding this flexibility to the persistent national divergences, it can be argued that the aim of enhancing the notion of accountability in this area will not be easily reached, as listed companies and national legal frameworks will continue to maintain their idiosyncrasies and preferences.

More generally, with regard to civil liability arising in this context, the Transparency Directive provides, under Article 7, that Member States should ensure that responsibility for information prepared and disclosed according to Articles 4, 5, 6 and 16 should lie at least with the issuer or its own administrative, management or supervisory bodies, as well as the relevant liability provisions are applicable to the issuers, the above-mentioned bodies and the persons responsible within the issuers. Therefore, there is a key requirement about a specific liability for the breach of periodic disclosure obligations. Nevertheless, the use of the conjunction 'or' in this

[42] *Ibid.*, Art. 40(2).
[43] Transparency Directive, *supra* n. 12.
[44] *Ibid*., Arts. 4-5.
[45] *Ibid*., Art. 4(2c).
[46] *Ibid*., Art. 5(2c).

framework has resulted in various national frameworks being able to continue to impose liability only upon issuers and to exclude natural persons completely.[47] Although several national laws have introduced directors' liability in this framework,[48] others have considerably complicated its implementation.[49] Even more flexible, some national laws continue to exclude such liability for directors.[50] This is particularly problematic because entity responsibility shifts attention away from the moral agent who is behind the reprimanded behaviour. A combination of issuer and directors' liability should therefore be adopted as

> [t]he capacity to take action simultaneously against the entity and the individual provides further capacity for the threat of regulatory action to promote compliance since neither the firm nor the individual can be sure of transferring responsibility to the other: in that situation, some degree of "constructive ambiguity" as to who will be held responsible may act as a useful deterrent even if action is only rarely pursued against individuals.[51]

Going beyond establishing specific liability for issuers or directors and examining more generally the openness of civil liability regimes to investor claims, similarly to prospectus disclosure obligations, the difference between national legal provisions is striking. Some Member States have traditionally been more receptive to

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[47] *See*, for example, the highly informative correspondence between Alexander Schaub (European Commission) and Lord Woolf (UK Financial Markets Law Committee) in 2006 http://www.fmlc.org/uploads/2/6/5/8/26584807/issue_76_letter_to_schaub_european_commission.pdf (accessed 15 May 2015), which emphasises the freedom that Member States enjoy with regard to the level and the spectrum of liability in this area. *See* also recital 17 of the Transparency Directive, *supra* n. 12.

[48] Spanish law accepts issuer and members of the administrative board liability: art. 35 LMV, art. 10, 17 RD 1362/2007.

[49] *See*, for example, in French law, the art. L. 225-251, alinéa 1er, Code de commerce, which requires the commission of a separable fault (*faute détachable*) to retain the directors' civil liability.

[50] UK law made an attempt, following the transposition of the Transparency Directive, towards a better liability regime by introducing a provision which is, nevertheless, applicable to issuers and not to directors: Section 90A Financial Services and Markets Act 2000 (liability restricted only to intent or recklessness, excluding thus issuer liability in the case of ordinary negligence). Directors can thus be sued only under general liability provisions. For a critical analysis of the UK civil liability framework, *see* Ferran, *supra* n. 15, at 342. *See* also John Armour, Bernard S. Black, Brian R. Cheffins and Richard Nolan, *Private Enforcement of Corporate Law: an Empirical Comparison of the UK and US* 6 Journal of Empirical Legal Studies 687, 712 (2009). Moreover, Germany abandoned the proposal for the introduction of a civil liability regime specifically for directors in this framework (*Kapitalmarktinformationshaftungsgesetz*). Of course, issuer liability may indirectly affect and deter directors who will be faced with the arduous task of managing sizeable losses associated with investor compensation: Paul Davies, *Liability for Misstatements to the Market: Some Reflections* 9 Journal of Corporate Law Studies 295, 301 (2009).

[51] MacNeil, *supra* n. 10, at 295.

the implementation of civil liability in this area,[52] contrary to others that continue to have highly complex or less protective civil liability provisions.[53]

Criminal sanctions in the area of periodic reporting are even rarer. Some national legislation provides for very dissuasive criminal sanctions, with 2, 3 or even 7 years of imprisonment being the most notable examples under French, German and UK law, respectively.[54] However, courts have traditionally been very reluctant to impose criminal sanctions due to the requirement of intent.[55] This raises questions as to the current usefulness and dissuasive force of criminal provisions that seem to be largely marginalised and designed such that they are very difficult if not impossible to apply.[56]

The area of administrative sanctions appears to show more optimistic signs for convergence, especially after the amendment of the Transparency Directive in 2013,[57] which triggered a considerable wave of reforms in this area. The amended Article 28 requires administrative measures and sanctions for breaches of national provisions dealing with periodic obligations. Such sanctions must satisfy the criteria of effectiveness, proportionality and dissuasion. Member States are also required to ensure that the members of the administrative, management or supervisory bodies of the issuer, as well as other persons held responsible for breaches, can be potentially subject to sanctions, under the condition that this is provided for at the national level.[58] This provision aims to retain liability both for issuers and natural persons in

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[52] In the past decade, French law has shown a gradual receptiveness to investor claims for incorrect periodic reporting and has repeatedly sanctioned issuers (and less frequently directors due to the *faute détachable* obstacle as explained above): for some interesting examples, *see* Veil, *supra* n. 28, at 266; Sergakis, *supra* n. 36, at 171.

[53] Germany and Sweden being notable in this area: Veil, *supra* n. 28, at 266.

[54] *See* n. 8, n. 9 and n. 10 *supra*.

[55] *See*, for example, in Germany, the Düsseldorf regional court in the *Mannesmann* case, retained only criminal liability for embezzlement, failing to establish the intentional element: LG Düsseldorf, *NJW* 3275, 2004. Moreover, in the highly publicised case of *EM.TV*, the court only fined the directors in an exemplary way (€1,200,000 for Thomas Haffa and €240,000 for Florian Haffa) without imposing any imprisonment: *Staatsanwalt Fordert für die Haffas eine Bewährungsstraffe*, Frankfurter Allgemeine Zeitung, 8 April 2003, No. 83, 20; *EM.TV's high-speed crash*, The Economist, 7 December 2000.

[56] Alternatively, the criminal framework has been used in some countries for purely compensatory purposes. For example, under French law, compensation can be awarded to an investor in a criminal proceeding, joining the proceeding as *partie civile* and under the conditions that she will be able to show a personal and direct damage: Éric Dezeuze, *La Réparation du Préjudice devant la Juridiction Pénale* 2 Revue des sociétés 261 (2003). This has been criticised as an indirect attempt to receive compensation by using the criminal framework in order to avoid the general civil liability provisions. Moreover, notwithstanding the legitimacy of the claim and the desire to be awarded damages, this indirect means of litigation risks transforming criminal sanctions into an easier compensatory tool and disempower their symbolic connotation and identity as a public enforcement dissuasive means.

[57] Transparency Directive, *supra* n. 12.

[58] *Ibid*., Art. 28(1)(2).

cases of periodic obligation breaches, while respecting national preferences with regard to the delineation of the liability spectrum, as previously analysed.

The most important element of the 2013 amendment of the Transparency Directive is undoubtedly the increased harmonisation in the area of administrative sanctions. New minimum sanctioning powers[59] have been conferred to national competent authorities with regard to, at least, the breaches contained in Article 28a and related to the failure to make periodic information public within the set deadlines as well as to notify the acquisition or disposal of a major holding. The phrase 'at least' leaves room to national competent authorities to adopt the same measures on a wider scale and can serve as a first model for further harmonisation in this area.

The administrative pecuniary sanctions provided under Article 28b are up to €10 million or 5% of the total annual turnover for legal persons and up to €2 million for natural persons. In both cases, sanctions can be up to twice the amount of the profits resulting from the breach, if such profits can be determined. Paragraph 3 of the same article mentions that Member States can provide for higher levels of pecuniary sanctions, along with additional sanctions or measures. Therefore, it will be very interesting to see whether national laws will adhere to these new series of administrative sanctions, apart from the two types of breaches mentioned under Article 28a for which the sanctions are compulsory, and gradually converge with regard to the severity, frequency and intensity of sanctions imposed. Under the current framework, administrative sanctions continue to vary significantly, a fact that strengthens the argument for further harmonisation.[60]

In order to coordinate the exercise of sanctioning powers amongst national competent authorities, Article 28c provides a very useful guide that can be taken into account in determining the type and level of administrative sanctions or measures.[61] Indeed, the 2013 amendment accentuates the need for indirect harmonisation in this area by focusing on the conceptual elements of sanctions and measures and by attempting to converge their perception, interpretation and implementation across national competent authorities. This indirect harmonisation effort is, in our opinion, a positive step towards gradual uniformity in the interpretation of the three sanctions

[59] Public statement, order to cease the conduct, which triggered the breach, and to avoid repetition of similar activities as well as administrative pecuniary sanctions.
[60] Veil, *supra* n. 28, at 267.
[61] The gravity of the duration of the breach, the degree of responsibility and the financial strength of the natural or legal person, the importance of profits as well as the losses suffered by third parties due to the breach, the level of cooperation with the competent authority and any eventual former breaches.

criteria required in various EU capital markets texts: efficiency, proportionality and dissuasion.

Lastly, Article 29 aims to accentuate the severity and deterrent effect of sanctions via compulsory disclosure requirements for competent authorities, which are required to publish every decision on sanctions and measures, while providing information on the type and nature of the breach as well as the identity of the natural or legal persons affected by the decision. Aware of the risks involved in increased transparency in this area, the Directive also allows competent authorities to delay such publication or to publish decisions anonymously if they believe that such an action would be disproportionate, would seriously jeopardise the stability of the financial system or an ongoing investigation, or would cause disproportionate and significant damage to related institutions or natural persons.

Mandatory disclosure of sanctions is undoubtedly a highly effective means of deterrence, as well as a strong trigger for market reaction. 'Naming and shaming' has traditionally been regarded as a social sanction that can theoretically become more serious than the sanction itself or even last longer, depending on the unpredictable cascading effects on investors, third parties and stakeholders at large.[62] Some Member States, such as the UK, France and Spain, have already adopted this practice with positive results. Nevertheless, other countries continue not to disclose the identity of concerned persons, evoking concerns about disproportionality and unpredictable market reactions. It will therefore be challenging to see how these Member States will handle all the practices in the future, especially after the increasing demand for such disclosure from the EU.

3.3 *Episodic Disclosure Obligations*

Episodic disclosure obligations arise on an *ad hoc* basis since listed companies are required to disclose inside information that directly concerns them to the public as

[62] Although some empirical studies, focusing on the French authority *Autorité des Marchés Financiers*, have suggested that a negative market reaction is triggered from the stage of the investigation announcement and that the formal sanction announcement does not seem to adversely affect the share price in the same way: Constant Djama, *Fraudes à l'Information Comptable et Financière et Contrôle de l'AMF. Une Étude des Réactions du Marché Financier Français* 2(231) Revue Française de Gestion 133 (2013). For a more general analysis of reputational sanctions, *see* Jonathan Karpoff and John Lott, Jr., *The Reputational Penalty Firms Face from Committing Criminal Fraud* 36 Journal of Law and Economics 757 (1993). *See* also Cindy R Alexander, *On the Nature of the Reputational Penalty for Corporate Crime: Evidence* 42 Journal of Law & Economics 489 (1999).

soon as possible.[63] Issuers are also allowed to delay such disclosure, under their own responsibility, if such disclosure would be likely to prejudice their legitimate interests, if its delay would be unlikely to mislead the public, and if the issuer is able to ensure the confidentiality of the inside information.[64]

Civil liability as well as criminal and administrative sanctions can result from breaches of the above-mentioned requirement. The Market Abuse Regulation provides, under Article 30, that Member States, without prejudice to any criminal sanctions, must empower national competent authorities to impose administrative sanctions and measures with regard to a series of infringements specified under the same article.[65]

Civil claims can encounter several obstacles in the area of episodic disclosure obligations, due not only to the considerable divergence of national legal provisions but also to the inherent difficulty of proving the causal link between the defective information and the decision to invest. Indeed, in this specific framework, information is disclosed instantaneously and its influence upon investors, who carry the burden of proof of such link,[66] may not be straightforward, especially in the presence of other concomitant factors that may be equally important to an investment decision. Moreover, it is common for national frameworks to provide only for issuer liability, thus excluding the responsible persons behind defective *ad hoc* disclosure practices in which they are usually more involved at a personal level, such as in the case of an interview with the financial press.

National laws have treated this topic in different ways, most of them having maintained their general civil liability provisions[67] and others having chosen to

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[63] Art. 17, Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC OJ L173/1. On the interpretational difficulties amongst market actors and national regulators surrounding the notion of 'inside information', *see* Jesper Lau Hansen and David Moalem, *The MAD Disclosure Regime and the Twofold Notion of Inside Information: The Available Solution* 4(3) Capital Markets Law Journal 323 (2009).

[64] *Ibid*., Art. 17(4). The late disclosure of good information can indeed be vital to the company, especially in the presence of an important deal that, if realised, will benefit both the company and its shareholders.

[65] *Ibid*., Art. 30(1).

[66] With the exception of Austrian law, where it is sufficient for investors to show that the defective information was known to the market at the time of the investment or that the omitted information was subject to a disclosure obligation: Veil, *supra* n. 28, at 304.

[67] French law deals with these breaches under art. 1383 of the *Code Civil*.

introduce specific provisions for this type of breach.[68] Although some highly-publicised cases have been subject to severe sanctions in certain jurisdictions,[69] it would be fair to say that national courts are still reluctant to facilitate civil claims, maintaining a rather conservative view of the impact of *ad hoc* disclosed information upon investment decisions.[70]

Criminal sanctions are typically rare and marginalised in this framework. Few Member States have provided for criminal sanctions for breaches of episodic disclosure obligations, a fact that denotes the rather auxiliary role that episodic disclosures are assumed to play in this area.[71] Adding to this reality, we should also bear in mind that criminal liability could be particularly difficult to establish in episodic disclosure strategies, as proving the intentional element can be arduous. This is true due to the instantaneous character of the disclosure itself, which may not always be helpful in establishing intent since the defendants could argue that they were not aware of the defective character of the information disclosed and that they did not proceed with such disclosure with such intent. Moreover, the marginalisation of criminal sanctions in this area may also be attributed to the fact that criminal liability can be established only with regard to the disclosure of defective information and not by the omission of disclosure of correct information, which can be common in this framework.

The signs of harmonisation on criminal sanctions at the EU level for episodic disclosure obligations are not particularly encouraging. The Market Abuse Directive adopted in 2014[72] has implemented minimum harmonisation in the area of criminal

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[68] German law has introduced paragraphs 37b (omission to disclose inside information) and 37c (disclosure of incorrect information) in the *WpHG* dealing with episodic disclosure obligations. UK law has introduced Section 90A Financial Services and Markets Act 2000, which establishes issuer liability together with Schedule 10A.

[69] Such as *Informatec* (*OLG* Munich, 23 *ZIP* 1989 [2002]), *EM.TV* (*BGH*, *NZG* 672 [2005]) or *Comroad* (*BGH*, *NZG* 386 [2008]) in Germany and *Flammarion* (CA Paris, 26 septembre 2003, *Soulier et autres c/ Flammarion et autres*) or *Eurodirect* (Cass. com., 22 novembre 2005, *Eurodirect Marketing c/M. X)* in France: for an extensive analysis, *see* Sergakis, *supra* n 36, at 211-214.

[70] For example, under German tort law, paragraph 823(1) BGB deals with infringements of a protective law but German courts have traditionally, with some exceptions, conceived of disclosure obligations as aiming to protect the market at large and not investors in particular. It cannot therefore be used in a civil claim unless an investor can show that she belongs to a protected category. Paragraph 826 BGB, dealing with intentional damage against public policy, seems to be more appropriate for a civil claim in this area but requires full level of proof, thus making successful claims very difficult.

[71] CESR, *Executive Summary to the Report on Administrative Measures and Sanctions as well as the Criminal Sanctions Available in Member States under the Market Abuse Directive* CESR/08-099, 2008, 34 http://www.esma.europa.eu/system/files/08_099.pdf (accessed 15 April 2015).

[72] Directive 2014/57/EU of the European Parliament and of the Council of April 16, 2014 on criminal sanctions for insider dealing and market manipulation [2014] OJ L173/179.

sanctions only with regard to serious and intentional infringements of some market abuse practices, such as insider dealing, unlawful disclosure of inside information and market manipulation.[73] Therefore, the provisions of the Directive do not cover breaches of episodic disclosure obligations, which continue to be exclusively determined by national laws. This is particularly unfortunate as further harmonisation in this area would be particularly welcome and would discourage inappropriate *ad hoc* disclosure practices that can harm investor confidence, destabilise capital markets and have serious effects upon the investor community. The Directive itself acknowledges the beneficial aspects of criminal sanctions for market abuse practices as a 'stronger form of social disapproval compared to administrative penalties'.[74] Nevertheless, the level of harmonisation introduced was minimal and with uncertain outcomes at the national level due to the remaining interpretation obstacles.[75]

Lastly, breaches of episodic disclosure obligations can trigger a series of administrative sanctions and measures. The most notable characteristic of the Market Abuse Regulation was the introduction of new thresholds with regard to pecuniary sanctions. First of all, for breaches of Article 17, national competent authorities can impose maximum administrative pecuniary sanctions of at least three times the amount of the profits related to the infringement, when the amount of such profits can be determined.[76] Moreover, natural and legal persons can be subject to maximum pecuniary sanctions of at least €1 million[77] and €2 million[78] (or 2% of total annual turnover), respectively. It is also worth noting that Member States retain the possibility of providing for higher levels of sanctions.[79] The Market Abuse Regulation thus aims to raise the minimum levels of maximum pecuniary sanctions, while leaving national laws the discretion to increase the severity of sanctions if they wish.

Similarly to Article 28c of the Transparency Directive, as analysed in the previous section, Article 31 of the Market Abuse Regulation provides a useful guide to the elements that must be taken into account by competent authorities when

[73] *Ibid*., Arts. 3-5.
[74] *Ibid*., Recital 6.
[75] Indeed, it will be particularly interesting to see how Member States will implement these provisions with regard to the 'seriousness' of a case that should trigger the harmonised sanction levels. Recitals 11 and 12 of the Directive provide some useful guidance in that respect but room for divergence is still inevitably present.
[76] *Ibid*., Art. 30(2h).
[77] *Ibid*., Art. 30(2i, ii).
[78] *Ibid*., Art. 30(2j, ii).
[79] *Ibid*., Art. 30(3).

determining the type and level of administrative sanctions.[80] It is clear that this alignment with the Transparency Directive aims to enhance indirectly a harmonisation trend amongst competent authorities that are now required to start designing, interpreting and implementing sanctions with regard to a fixed minimum of circumstances applicable at the EU level. This is undoubtedly, as in the case of periodic disclosure obligations,[81] an encouraging step towards gradual convergence of the *modus operandi* of national competent authorities that may prove even more useful than formal harmonisation measures, which deal with minimal penalties, insofar as it could accustom authorities to a new way of thinking and calculating the severity of sanctions, adopting a much more holistic approach that may not necessarily coincide with traditional approaches.[82]

Another argument that could be advanced in acknowledging the EU framework's responsiveness to deficient disclosure strategies is related to the accentuation of sanctions in the case of information-based market manipulation. Indeed, Article 12 of the Market Abuse Regulation considers market manipulation to be the dissemination of information, through the media or by any other means, that gives or is likely to give false or misleading signals regarding, amongst other things, a financial instrument. According to Article 30(2j, i and ii), the administrative

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[80] The gravity of the duration of the breach, the degree of responsibility and the financial strength of the natural or legal person, the importance of profits as well as the losses suffered by third parties due to the breach, the level of cooperation with the competent authority, any eventual former breaches and any measures taken for the prevention of repetition of the breach.

[81] The alignment with the Transparency Directive is also evident from Art. 34 of the Market Abuse Regulation that deals with the requirement for competent authorities to publish immediately on their website any decision imposing an administrative sanction or measure. The publication must include information with regard to the time in the nature of the breach, as well as the identity of the person concerned: *ibid*., Art. 34(1). Also, in the presence of disproportionality with regard to the person concerned or of risks of this mobilising the financial markets for compromising an ongoing investigation, competent authorities may defer the publication, publish the decision anonymously or even avoid the publication: *ibid*., Art. 34(1)(a)(b)(c).

[82] *See*, for example, the relatively modest rates of administrative sanctions by the FSA (predecessor of the FCA): Paul Davies, *Davies Review of Issuer Liability*: *a Discussion Paper* 29 (2007). Nevertheless, the FSA had imposed a £17 million penalty on Shell in 2004 for breach of disclosure obligations <http://www.fca.org.uk/your-fca/documents/final-notices/2004/fsa-final-notice-2004-the-shell-transport-and-trading-company> accessed 15 May 2015. On a much more frequent basis, the FCA has engaged more recently in the imposition of highly dissuasive penalties: *see* for example the penalty of £539,800 imposed on Reckitt Benckiser Group Plc in 2015 <http://www.fca.org.uk/static/documents/final-notices/reckitt-benckiser-group-plc.pdf> accessed 15 May 2015 and the £2.4 million penalty imposed on Lamprell Plc in 2013 <http://www.fsa.gov.uk/static/pubs/final/lamprell.pdf> accessed 15 May 2015. Such a trend testifies to a more general shift towards a more active public enforcement agenda, inevitably triggered by the more general ramifications of the financial crisis: Schammo, *supra* n. 21, at 56. More generally on different economic, legal and institutional infrastructures as well as complementary mechanisms that influence this framework in the UK, *see* Cearns and Ferran, *supra* n. 5, at 209-210, 223.

sanctions, applicable to Article 15 which prohibits market manipulation, can be much higher for both natural and legal persons, who can be subject to maximum pecuniary sanctions of at least €5 million and €15 million (or 15% of total annual turnover), respectively. In this case, the Market Abuse Directive would also be applicable because, in characterising this behaviour as market manipulation in its Article 5(2c), it provides for a criminal offence in its Article 6 as well as a maximum term of imprisonment of at least four years in its Article 7 for natural persons, as well as other types of sanctions for legal persons in its Article 9. More generally, an information-based market manipulation could also be related to similar violations of prospectus or periodic disclosure obligations.

Could it therefore be reasonably argued that the applicability of market manipulation rules would solve the lack of harmonisation or sufficient rigour of sanctions at the EU level? As mentioned in the beginning of the article, any sanction system that provides for a general availability of sanctions for similar types of behaviour fails to take into consideration some important elements of the defective disclosure strategies – as our experimental analysis has attempted to show in this article. Enhancing the severity of sanctions in the presence of market manipulation can only be a positive sign, but the general framework in which courts and regulators will be asked to exercise their functions deprives the legal system of a possibility to develop and apply more targeted enforcement tools against equally sophisticated corporate disclosure strategies. Moreover, the harmonisation gap would persist due to the same pattern followed across the applicable EU Directives and Regulations. Therefore, the relationship between time and sanctions is deemed to be a more innovative approach for increasing the efficiency of sanctions, and this should prevail in designing a new enforcement approach.

It should also be borne in mind that market manipulation rules are only a subset of the entirety of defective disclosure strategies. The key characteristic of market manipulation strategies in this area can be identified as their potential to interfere with the market price-efficiency principle by giving misleading signals regarding the financial instrument. It can be therefore plausibly argued that these strategies only touch upon some of the defective disclosure strategies adopted by companies and, as such, cannot qualify for a blanket prohibition for all cases that are discussed in our article.

We will now turn our focus to the new enforcement approach issue.

4. The *De Facto* Harmonisation of Sanctions at the EU Level

4.1 *The Creation of 'Aggravating Disclosure Circumstances'*

The notion of aggravating circumstance, well known in criminal law,[83] is used by the courts to consider the seriousness of an offence when calculating the severity of the sentence imposed. The general justification for considering such circumstances is the required particular attachment to specific facts surrounding an offence that give reasonable grounds for a more severe sentence. Courts are thus allowed to take into consideration a vast series of circumstances to determine the seriousness of the offence and to acknowledge a greater degree of severity and dissuasion in the sentence imposed. It obviously remains up to the courts to decide on a case-by-case basis whether such circumstances justify a stronger sentence or, if not present, they will remain in the general framework applicable to the offence in question.

Nevertheless, legislating a series of circumstances to guide the courts to impose stronger sentences creates a trend for more frequent severe sentences imposed while reinforcing the dissuasive force of sanctions. This is plausible because individuals violating the law are not in a condition to calculate in advance all the potential aggravating circumstances and hence when the sentence is imposed, the overall outcome might be different from the one expected when they committed the offence and thus much more dissuasive for potential future offences.

Moreover, apart from increasing the dissuasive force of the sanction, including aggravating circumstances in a legal system aims to make the seriousness of an offence more visible with regard to the surrounding circumstances on a case-by-case basis. In other words, courts are allowed to take into consideration certain circumstances in order to target the offence in question in a more sophisticated and holistic way as it occurred. The legal framework's responsiveness to the commission of an offence with special characteristics therefore makes the overall system much more effective, aiming to sanction not only the offence but also its commission in a particular way that makes it much more serious given the circumstances.

[83] In UK law, *see* Criminal Justice Act 2003, Section 143(1).

Following this line of reasoning, given the explanation of the importance of time manipulation in listed companies' breaches of disclosure obligations in Section 2, this article argues that EU capital markets law could use the concept of aggravating circumstances and introduce 'aggravating disclosure circumstances', expanding their application to all possible sanctions imposed in this area, namely civil liability as well as criminal and administrative sanctions.

Such a reform would allow courts and national competent authorities to increase the quantum of sanctions considerably, while clearly conveying the dissuasive force of sanctions to listed companies and their directors. The more severe sanction imposed will therefore be based upon the fact that the disclosure or omission of information took place in a specific time framework adjacent to either a prospectus, periodic or episodic framework. The time element will be specified in light of its favourable impact on the company when the latter decided to disclose incorrect information or to omit true information in either of the above-mentioned frameworks.

We must remember that the proposed system does not aim to create maximum harmonisation at the EU level, but only to introduce a common mentality amongst courts and competent authorities regarding the appropriateness of increasing the severity of sanctions in this field. By not intervening directly in the calculation – i.e. the minimum or maximum levels – of sanctions but by allowing courts or authorities to dispose of further tools to increase the quantum of sanctions, the proposed scheme does not aim to resolve the continuing divergence amongst national frameworks. This is because we acknowledge that convergence in this framework might not take place in the near future due to persistent differences in various legal traditions.[84]

We therefore believe that by allowing the use of 'aggravating disclosure circumstances' and the increase of the sanction imposed, the main benefit will be the gradual convergence of various national frameworks with regard not to the minimum or maximum potentially imposed penalties, but rather the mentality adopted when courts or authorities sanction the breach of disclosure obligations. In other words, our proposal seeks to harmonise the *perception* of each and every breach involving time manipulation, obviously when breaches take place in such a way. By allowing for more severe sanctions on a case-by-case basis, even though this sanction applies every time in a different national legal framework with different applicable

[84] *See* the analysis contained *supra*, Sections 3.1, 3.2 and 3.3.

provisions, our proposal will guide courts and authorities towards the same stance on the need to increase the severity of sanctions.

Under this proposal, all sanctions imposed will inevitably continue to vary, but the clear advantage is to create a *de facto* harmonisation trend in the treatment of any breach by targeting its specific conditions in a more sophisticated way. By intensifying and multiplying the triggering of higher quantum of various sanctions, this proposal will have beneficial ramifications at various levels. On the one hand, if a national competent authority or judges have a limited margin for appreciation, because the applicable legal provisions provide for a quite modest maximum level of sanction, adopting this new scheme will allow them to impose an even more severe sanction and thus overcome the questionable dissuasive force of the framework in which they operate.

On the other hand, if this new scheme is applied in a legal framework that is theoretically very persuasive, providing a very onerous maximal level of sanctions, but lacks considerably in implementation,[85] it will again have beneficial outcomes since it will allow authorities or judges to base their decisions on an additional element in order to increase the severity of the sanction imposed. The case-by-case use of this proposal will inevitably trigger more severe sanctions and will allow a 'formally rigorous' framework to retain its dissuasive force by becoming 'substantially rigorous'. The 'law-in-action' facet of sanctions will thus be favoured against a 'law-in-books' approach.[86]

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[85] With regards to regulators, this may be due to budgetary implications that reduce effectiveness, to the lack of political support or even to the regulatory preference 'to enjoy the quiet life': John C. Coffee, *Law and the Market: the Impact of Enforcement* 156 University of Pennsylvania Law Review 229, 244 (2007). With regard to regulatory discretion more generally in this area and its potential implications for enforcement policies, *see* MacNeil, *supra* n. 10, at 284.

[86] Bearing the above-mentioned facts in mind, criticism could be formulated against this proposal with regard to the efficiency of the implementation of such a framework in very lax legal systems where sanctions are not dissuasive. In other words, allowing authorities or judges to increase the quantum imposed in a less rigorous legal system will not necessarily result in reaching the severity of the minimum quantum of another much more rigorous legal system. Even if we accept this line of reasoning, the proposal still has a clear justification since its aim is not to harmonise legal frameworks directly but to trigger a 'race to the top' trend with regard to the application and imposition of sanctions.

Under this assumption, the probability for a national legal framework to undertake reform to align itself with other more rigorous legal provisions in other Member States will be much higher thanks to the more frequent imposition of more severe sanctions by judges and national authorities via the mechanism explained above. In other words, apart from indirectly harmonising the mentality regarding the severity of sanctions, this mechanism can trigger possible legal reforms in the national framework stemming from a repetitive trend of imposing more severe sanctions under the influence of the 'aggravating circumstances' scheme. Our study does not obviously neglect the probability for such a 'race to the top' to remain at a purely theoretical level since the lack of implementation will always

The ideological basis of our proposal appears to be more realistic than a maximum harmonisation scenario that seems less probable even in the near future. Moreover, the advantage of taking into consideration special circumstances related to time manipulation seeks to make the overall system much more sophisticated in the way that it targets illegal practices. The European Commission could issue a Recommendation suggesting that Member States strengthen the severity of sanctions following the concept of 'aggravating disclosure circumstances' for each type of disclosure obligations. The Recommendation could provide further guidelines, explained below, on the aggravating circumstances warranting a more severe sanction, as well as the calculation of the quantum imposed.

Of course, the Recommendation may appear to be a relatively disappointing outcome since it will not be in a position to ensure immediate adoption of the proposed provisions. It is nevertheless necessary because it is a much more realistic means to indirectly create a growing trend of convergence in the perception of 'aggravating disclosure circumstances'. Assuming that political consensus is reached upon the merits of this method, following the Recommendation, the European Commission could include this system in the respective texts of the Prospectus, Transparency and Market Abuse Directives and Regulations, and provide for Member States to ensure that the offences are punishable by effective, proportionate and dissuasive measures and penalties, taking into consideration 'aggravating disclosure circumstances' to which our article will now turn.

4.2 *The Enhancement of Different Types of Sanctions for Different Types of Violations*

(a) Enhanced Damages for Prospectus Disclosure Obligation Breaches

Beginning with prospectus disclosure obligations, it is rather straightforward to assume that the prospectus itself, along with the information provided therein, constitutes the first point of contact as well as the main source of information for

stand as an impediment to the increase of enforcement intensity. This convincing argument has been formulated by Professor John C. Coffee as 'bonding hypothesis' in his work *The Future as History: the Prospects for Global Convergence in Corporate Governance and its Implications* 93 Northwestern University Law Review 641, 691-692 (1999). *See* also by the same author *Racing Towards the Top?: the Impact of Cross-Listings and Stock Market Competition on International Corporate Governance* 102 Columbia Law Review 1757, 1830 (2002).

investors in the case of an IPO – a private company that is about to list its shares on a regulated market – or a listing of additional shares in capital markets – a publicly-traded company that decides to list additional shares. Bearing in mind that the information disclosed in the prospectus is the main vehicle of the company's message to the investor community in this special occasion that is driven by capital-raising motives, we can plausibly assert that a company that decides to disclose incorrect information or to omit true information in the prospectus is doing so to maximise its capital-raising potential. This corporate strategy is mainly based on a willingness to capitalise as much as possible on profits by projecting an inaccurate image to an investor community that may not necessarily know the company's profile in depth or may not be able to fully evaluate the implications of an additional listing of shares.[87]

Especially in the case of an IPO, even if we assume that investors or their intermediaries will thoroughly examine the information contained in the prospectus, in most IPOs, they will not be in a position to evaluate the company's profile in depth since the company is about to list its shares on capital markets for the first time[88] and hence a holistic approach with regard to the viability of an investment project can be particularly arduous.[89] This novel contact with a company, combined with the investor community's lack of familiarity with the company's profile, must be taken into consideration along with the corporate strategy that seeks to extract the maximum profit out of a situation that seems to be asymmetric at an informational level.[90]

In order to understand this particular asymmetry and its potential exploitation by a company seeking to attract as much capital as possible from the investor community, it would suffice to compare this with the periodic and episodic disclosure obligations. In the periodic disclosure framework, an already-listed company must disclose information in various reports and hence its main motivation when deciding to violate the disclosure framework is not the attractiveness of a maximum amount of capital at a specific occasion, as in the case of an IPO, but the maintenance of its

[87] '[T]he issuer has an extra incentive to hide bad news in fund raising because, unlike with continuing disclosures, it stands to benefit directly from any extra amount investors can be induced to pay for the securities on offer': Davies, *supra* n. 44, at 303.

[88] Jeremy C. Stein, *Agency, Information and Corporate Investment*, in *Handbook of Economics and Finance*, 111 (North Holland; Elsevier Science Ltd, 2003).

[89] Susanne Kalls, *Anlegeninteressen. Der Anleger im Handlungsdreieck von Vertrag, Verband und Markt*, 102 (Wien; Springer Verlag 2001).

[90] It should also be noted that the role of the investment bank in this framework is crucial: indeed, it can act as an efficient gatekeeper by providing the profit forecast for the prospectus, and it also bears the respective liability for it.

existing investors and its share price. Therefore, in this framework, any disclosure of incorrect information is mainly motivated by the willingness to preserve investor confidence and the successful continuity as a listed company or, in the case of omission of disclosure of true information, the avoidance of a drop in the share price that would occur if the company decided to be transparent and to disclose negative news about its financial condition.

The same observation can be formulated on the episodic disclosure obligations that occur instantaneously. Companies may be interested in exploring an *ad hoc* opportunity by disclosing incorrect information via an interview with the financial press or a post on their website, knowing in advance the immediate effect of the disclosure on the share price. Their main concern is not to maximise profits or attract capital, but rather the need to influence the market value of the shares by intervening on an *ad hoc* basis in the market's perception of its financial condition and business prospects.

Returning to the prospectus disclosure obligations, we can plausibly assert that the motives of a company deciding to violate these obligations are quite different depending on the time framework of an operation. Therefore, legal provisions must target any breach in a way that neutralises not only its harmful effects to the market and investors, but also the sizeable profits that can be generated in this framework, largely exceeding the losses suffered by the harmed investors.[91] A possible way forward would thus be to introduce damages, akin to punitive[92] or exemplary[93] damages, that would be awarded on the top of compensatory damages and would be calculated by courts on the basis of the profits generated from the defective disclosure

[91] Our proposal is also aligned with previous research highlighting the importance of enhancing liability towards the civil remedies direction. Indeed, private enforcement is favoured, in this particular area, by a considerable number of academics as it has been perceived as an effective system that matters in securities laws: *see*, most notably, La Porta, Lopez-de-Silanes and Shleifer, *supra* n. 9, at 5.

[92] Clarence Morris, *Punitive Damages in Tort Cases* 44 Harvard Law Review 1173, 1174 (1931): '[I]n the liability with fault cases there is an admonitory function as well as a reparative function: and the linkage of these two functions supplies a reason for taking money from the defendant as well as one for giving it to the plaintiff.' *See* also William M. Landes and Richard A. Posner, *The Economic Structure of Tort Law*, 160 (Cambridge; Harvard University Press, 1987).

[93] Exemplary damages are available in UK law only in very limited cases, namely unconstitutional acts by government servants, when 'the defendant's conduct has been calculated by him to make a profit for himself which may well exceed the compensation payable to the plaintiff' and lastly when there is an express authorization by statute: *Rookes v. Barnard* [1964] AC 1129, [1964] 1 All ER 367. It is thus the second category of actions that may be relevant in breaches of prospectus disclosure obligations given the above-mentioned analysis. Nevertheless, *see* the leading case *Devenish Nutrition Ltd v. Sanofi-Aventis SA (France)* [2009] 3 All ER 27, which denotes the limitations to extracting restitutionary damages in English courts.

strategies.[94] These additional damages would thus aim at deterring companies from future defective practices while functioning as a punitive tool[95] with a strong social connotation[96] aiming to target optimally the exploitation of the prospectus disclosure framework and the consequent generation of illegal profits. These damages should be awarded only in cases of fraud, not for negligence. Moreover, respecting the predominant compensatory feature of damages, which should not exceed the loss suffered by harmed investors, the additional damages could be paid to the national Treasury – or homologue bodies in other countries.[97]

More generally, although the award of punitive/exemplary damages has undoubtedly gained momentum in US law, and our proposal could thus be more easily accepted in that framework, it has been accepted with much reservation and only rarely in UK law (and under much criticism).[98] Moreover, it has received much less enthusiasm in EU law.[99] This reluctance could create substantial obstacles to the

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[94] More generally, regulators, such as the FCA, also have powers to seek restitution orders from the courts for persons who have infringed Part VI (Official Listing) of the FSMA: Financial Services and Markets Act 2000, Section 382. This applies to situations where profits have been made or losses caused as a result of the infringement, and the court can require a fair amount (taking into account the profit made or the loss occurred) to be paid to the FCA which would then distribute it to the persons who have suffered loss.

[95] *Gertz v. Robert Welch Inc*., (1974) 418 US 323.

[96] Catherine M. Sharkey, *Punitive Damages as Societal Damages* 113 Yale Law Journal 347 (2003).

[97] For a similar proposal that was put forward in France with regard to the reform of the art. 1370 of the Code Civil, *see* Pierre Catala, *Avant-Projet de Réforme du Droit des Obligations et de la Prescription, Rapport au Garde des Sceaux* 170 (2005) http://www.justice.gouv.fr/art_pix/RAPPORTCATALASEPTEMBRE2005.pdf (accessed 11 May 2015).

[98] Allan Beever, *The Structure of Aggravated and Exemplary Damages* 23 Oxford Journal of Legal Studies 87 (2003). More generally and beyond the exemplary damages framework, it should be noted that damages relating to deceit are not necessarily limited by the usual remoteness rule, in the case of intentional wrongdoing, due to the fact that 'moral considerations militate in favour of requiring the fraudster to bear the risk of misfortunes directly caused by his fraud': *Smith New Court Securities v. Citibank* [1997] AC 254, 279-280 (Lord Steyn). This wider liability, accepted only in the case of intentional wrongdoing, is undoubtedly a positive sign for investor protection.

[99] For an overview, *see* Cedric Vanleenhove, *Punitive Damages and European Law: Quo Vademus?*, in *The Power of Punitive Damages - Is Europe Missing Out?*, 337 (Cambridge-Antwerp-Portland; Intersentia, 2012). *See* also Art. 13(1b) of the Directive 2004/48/EC of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights [2004] OJ L195/16: 'When the judicial authorities set the damages (a) they shall take into account all appropriate aspects, such as … any unfair profits made by the infringer … ; or (b) as an alternative to (a), they may, in appropriate cases, set the damages as a lump sum on the basis of elements such as at least the amount of royalties or fees which would have been due if the infringer had requested authorisation to use the intellectual property right in question.' The Directive also specifies in recital 26: '[t]he aim is not to introduce an obligation to provide for punitive damages but to allow for compensation based on an objective criterion'. Most importantly, in French law, art. L.331-1-4 paragraph 4 of the *Code de la propriété intellectuelle* provides that the court may order the confiscation of all or part of the proceeds which were generated from the infringement of a copyright and award them to the harmed party. Even if the damages awarded in this framework cannot be considered punitive, it is plausible to deduce an indirect punitive character since the unfair profits co-determine their final amount and the confiscation operates in the same spirit.

implementation of the current proposal at the international level. Nevertheless, the need to use civil liability as a framework for deterrence has not been completely ignored in civil law jurisdictions[100] and national courts have, at times, found alternative ways that result in damages which go beyond the pure compensatory limit of the loss suffered.[101] Although such a possibility might be difficult to implement, the awarding of additional damages should not be excluded in the future given their important function in targeting the considerable profits realised.[102]

Therefore, we believe that the inclusion of 'aggravating disclosure circumstances' in this area by providing that national courts can impose additional damages if the disclosure breach has occurred in the prospectus framework will significantly address the specific time manipulation element that allows companies to realise considerable profits. Harmonisation of these measures at the EU level could not be realistically achieved, and this is why it would be preferable to allow national legal systems to evolve around this proposal and adopt compatible solutions within their legal traditions.[103] An EU Recommendation could thus suggest to Member States to strengthen the severity of civil liability following the concept of 'aggravating disclosure circumstances' by adding provisions for the courts to take into consideration damages based on the profits generated from the breach of a prospectus disclosure obligation and payable to the national Treasury – or homologue bodies in other countries.[104]

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[100] *See*, for example, the attempts to introduce punitive damages in French law in 2005 and 2009, which were nevertheless abandoned: Catala, *supra* n. 91, at 170; Alain Anziani and Laurent Béteille, *Rapport d'Information du Sénat n° 558 sur la Responsabilité Civile* 79 (2009) http://www.senat.fr/rap/r08-558/r08-5581.pdf (accessed 11 May 2015).

[101] For a series of examples, *see* Thomas Fausten and Robert Hammesfahr, *Punitive Damages in Europe: Concern, Threat or Non-Issue?* Swiss Re (2012) http://www.biztositasiszemle.hu/files/201206/punitive_damage_in_europe.pdf (accessed 11 May 2015).

[102] At the same time, investor confidence in IPOs or listing of additional shares needs to be protected sufficiently to preserve the vibrant character of capital markets. Therefore, exemplary damages can be crucial not only to preserve the confidence of harmed investors in the market but also to reassure the rest of the investor community that prospectuses and the surrounding legal framework ensure a high level of informational rigour.

[103] Another challenging issue would be identifying potential claimants and the likelihood of their filing suit, given the absence of a 'US class actions' model in securities law that certainly facilitates the initiation of litigation. This article acknowledges such limitations but does not focus on procedural aspects of private enforcement issues.

[104] The involvement of the national Treasury also seeks to increase the punitive function of the awarded damages in this framework and to give a social connotation to an area whose main purpose is compensatory. This social connotation is–in our view–justified due to the pivotal importance of the 'entry stage' in capital markets and to the need of awarding the 'listed company' status only to issuers that respect a rigorous legal framework. More specifically, one could advance the argument that since the prospectus obligations are so critical with regard to the informational veracity which needs to be

The Recommendation recital could elaborate the above-mentioned proposal as follows:

> Breaches of prospectus disclosure obligations can be explained in the light of the considerable potential in raising capital as well as in realising profits by exploiting a moment in time where the investor community does not have a sufficient amount of familiarity with company profiles. National laws should take into account these aggravating disclosure circumstances when reviewing their civil liability regimes. Civil liability can be viewed as an effective tool to target and reflect such capital-raising motives and should be strengthened in order to deter companies from breaching prospectus disclosure obligations. Member States should enable civil courts to impose additional damages taking into account these aggravating disclosure circumstances as well as the amount of profits resulting from the breach.

The Recommendation article could be formulated as follows:

> Member States should take the necessary measures to ensure that national courts can impose additional damages in the presence of a fraudulent breach of prospectus disclosure obligations. These additional damages should be based on the profits resulting from the breach and should be payable to the national Treasury of the Member State.

Moreover, and regardless of whether these damages are introduced, concerns over deterrence[105] in prospectus liability, arising from any potential facilitation of civil claims, could be mitigated given the detailed character of prospectus disclosure

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secured during the 'entry stage' of a company in capital markets, it would be also wise to enhance criminal sanctions in this area to further increase the deterrence against deviant practices as well as to transmit a strong 'social stigmatisation signal' to the market. Following this line of thinking, our proposal for enhancement of only civil liability could indeed appear to lead indirectly to a weakening of the 'social stigmatisation signal' and focusing primarily on the financial aspects of the breach of a prospectus obligation, allowing companies to calculate in advance the costs of non-compliance and choose to compensate the harmed investors to escape further sanctions. Although this reasoning has a clear rationale, we firmly believe that sanctions in this area should target the predominant motive for a breach, which is the profit maximisation objective, and associate their dissuasive character principally with this motive. The involvement of the national Treasury will therefore seek to ensure the 'social stigmatisation' by channelling the additional damages awarded back to the public sector.

[105] Triggering an overly cautious approach with regard to the content of the disclosed information to avoid a highly risky liability regime and thus reducing the benefits of disclosure for investors.

obligations and, most notably, the considerable prospectus preparative process involving the issuer and other parties.[106] Indeed, these two characteristics could, in our opinion, further strengthen the legitimate presence of increased civil remedies in this area.[107]

(b) Enhanced Criminal Sanctions for Periodic Disclosure Obligation Breaches

Increased criminal sanctions in the periodic obligations framework seem more appropriate to achieve a maximum of dissuasion and to discourage companies from exploiting the information in this area. The preparation of documents that are supposed to be diffused to the market periodically requires a high level of sophistication within the company, as well as rigorous control by auditors as to the accuracy of the information contained in various documents. The long preparatory process of periodic information, the high degree of sophistication in the various reports and, most importantly, the fact that these reports become the main communication method between a company and the rest of the market on a periodic basis,[108] may justify the adoption of more severe sanctions for defective 'price sensitive'[109] information.

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[106] Davies, *supra* n. 44, at 303-304.

[107] There are also additional factors that need to be taken into consideration: on the one hand, there is always a risk of triggering a 'cyclical movement of wealth transfer' in the case of issuers being exposed to increased damages with the ultimate outcome of placing excessive financial risk on the companies themselves as well as the interests of shareholders (who may also well be the claimants in the proceedings). On the other hand, implementing this proposal in jurisdictions where class actions are the main tool for private enforcement (the US being the most representative example) would risk further exacerbating 'pocket-shifting' with the transfer of substantial costs to various agents (e.g. lawyers): for a discussion of 'pocket-shifting', *see* MacNeil, *supra* n. 10, at 294. The article acknowledges the limitations arising in such a context with regard to the 'wealth transfer' and 'pocket-shifting' phenomena but it is–in our view–essential to create a sufficiently deterrent 'entry point' to the capital markets by enhancing such damages in the prospectus obligations framework. Therefore, enhanced damages should be supported as a highly deterrent legal provision to ensure compliance with the respective obligations.

[108] Although it is equally true that an important amount of information contained in these reports is already well known to the market due to information that has been disclosed *ad hoc* in various occasions throughout the financial year and reproduced in the annual or half-yearly reports. Nevertheless, these reports do present an important occasion upon which all interested parties evaluate the company at fixed intervals while examining the bulk of information contained in these reports in order to obtain a holistic view of the investment position. It is therefore crucial to conceive of this moment in time as independent from previous *ad hoc* disclosure strategies whose content may be included in these reports amongst other information.

[109] 'Price sensitive' information refers to any information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments or derivative financial instruments, namely 'information a reasonable investor would be likely to use as part of the basis of his

Increased severity would be most efficient with stronger criminal sanctions, which have traditionally been regarded as the most symbolic sanctions due to their social connotation, as well as one of their main elements that remains a basic threat to company directors, namely imprisonment. The particular importance attached to this information is visible in the expectations of current and prospective shareholders for periodic information of crucial importance that influences their future investment strategies. Moreover, the fact that the information intervenes in their decision-making strategies at fixed, predictable and well-known intervals of time is potentially a factor that gives it a more significant impact on investment decisions as well as its 'ethical' connotation, especially when compared with prospectus or *ad hoc* obligations.

Indeed, we could argue that periodic information maintains and further enhances investor interest in a company, as well as their perception of the continuity of their investment.[110] As such, this type of information could be seen as conveying motives or more ethical matters rather than purely financial elements, as would be the case with prospectuses or *ad hoc* disclosure events that mainly concern the financial attractiveness of a prospective investment. It should also be noted that periodic reporting (such as annual reports) further enhances the ethical dimension of this disclosure framework since such reports also include environmental, social and governance (hereinafter ESG) factors.[111] The new EU rules in this area inevitably make periodic reporting a matter of pivotal importance not only for shareholders but also for stakeholders who may be affected by companies' activities. Periodic disclosure policy thus encompasses an accountability focus for listed companies and not the pure market efficiency focus traditionally prioritised by the various EU Directives.

Moreover, *ad hoc* disclosures are more likely to have a positive share price impact on the company if the news they convey is positive, whereas periodic

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or her investment decisions': Art. 7(4), Regulation (EU) No 596/2014, *supra* n. 57. In fact, the enhancement of criminal sanctions for the breach of periodic disclosure obligations with regard to any type of periodic information would not be justifiable and such an increase in the quantum imposed or the duration of imprisonment should be confined in breaches related to price sensitive information. The author is particularly grateful to Commissioner Carmine Di Noia for this argument.

[110] Indeed, the enhancement of sanctions in the Transparency Directive in 2004 was associated with the need 'to increase confidence in the accounts and annual reports on which investors base their decisions in the light of revelations of board misbehaviour in … corporate scandals.': Charlotte Villiers, *Corporate Reporting and Company Law*, 72 (Cambridge; Cambridge University Press, 2005).

[111] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] OJ L330/1: Art. 19a.

information aims largely to maintain the shareholder base and to ensure continuity in company affairs. The reinforcement of criminal sanctions is thus more important in preserving the veracity of periodic information, given its 'ethical' nature in the eyes of the investor community and the public at large. An EU Recommendation could thus encourage Member States to accentuate the severity of criminal sanctions following the concept of 'aggravating disclosure circumstances' by introducing provisions for courts to impose more severe criminal sanctions, including imprisonment or fines, in cases of periodic disclosure obligation breaches.

The Recommendation recital could encapsulate the above-mentioned proposal as follows:

> Breaches of periodic disclosure obligations should attract a stronger form of social disapproval since such disclosures constitute the main and continuous vehicle for communication with shareholders and other market actors. Periodic disclosure obligations intervene in investor decision-making strategies at fixed, predictable and well-known intervals of time. Therefore, they become a crucial factor that significantly impacts investment decisions. National laws should take into account these aggravating disclosure circumstances and enhance criminal sanctions. Criminal sanctions can be viewed as an effective tool to target and reflect such disclosure motives and should be strengthened in order to dissuade companies from breaching periodic disclosure obligations. Member States should adopt more stringent criminal law rules and enable courts to impose higher fines and higher levels for the term of imprisonment taking into account in these aggravating disclosure circumstances.

The Recommendation article could be worded as follows:

> Member States should adopt more stringent criminal law rules and enable courts to impose higher fines and higher terms of imprisonment taking into account the aggravating disclosure circumstances present in the breach of periodic disclosure obligations.

We will now turn to the necessity of increasing the severity of administrative sanctions for breaches of episodic disclosure obligations.

c) Enhanced Administrative Sanctions for Episodic Disclosure Obligation Breaches

Preventive control measures targeting the truthfulness of episodic disclosure obligations present a particular difficulty because such obligations are fulfilled in an unpredictable way and via various communication means. The distinctive feature of any information disclosed in an *ad hoc* framework is the instantaneity of its disclosure and its capacity to have an immediate impact upon investors and the market at large. The rapid effect of such disclosure strategies on investment decisions is inevitably linked with short-term considerations since companies are well aware of the fact that the announcement of very optimistic news will suffice to raise their share price considerably while attracting a sizeable number of new investors. Given these features combined with the facilitated access to such information,[112] which makes it more important and increases its potential impact on a wide investor community, the applicable legal provisions must foresee the use of all these opportunistic advantages for companies and respond to breaches of episodic disclosure obligations in a more targeted and sophisticated way.

This can occur by strengthening administrative sanctions, which are more dynamic and rapid than civil or criminal procedures and sanctions. This is particularly true taking into account the regulatory 'know how', built up through regular contact with companies,[113] the rapidity of investigations and imposition of sanctions by national competent authorities and, lastly, the variety of sanctions available to these authorities. All these elements testify to the need to strengthen administrative sanctions for breaches of episodic disclosure obligations. Under our proposed scheme, competent authorities will thus be authorised to impose more severe pecuniary sanctions in this specific framework, strengthening the dissuasive force of sanctions while making them more sophisticated in their responsiveness to breaches occurring in an instantaneous and short-term framework. The efficiency of sanctions also depends on the capacity of legal provisions to target and adopt the same criteria as

[112] Financial press, company's website and other means.
[113] Frank Martin-Laprade, *La Politique de Sanction du Régulateur: Répression ou Réparation?* 9-10 Bulletin Joly Bourse 439 (2009).

with corporate strategies, in terms of both speed and instantaneity. Administrative sanctions satisfy both these criteria and are therefore more adequate to ensure an efficient enforcement method.

As previously analysed, the Market Abuse Regulation has undertaken a harmonisation effort by creating minimum and maximum amounts of pecuniary sanctions for breaches of episodic disclosure obligations, while allowing Member States to provide for even higher sanction levels.[114] It is therefore beneficial for national laws and authorities to take into account the proposed scheme and strengthen administrative sanctions even further within this framework. An EU Recommendation could thus incite Member States to strengthen the severity of administrative sanctions following the concept of 'aggravating disclosure circumstances' by introducing provisions for competent authorities to impose higher administrative sanctions in cases of episodic disclosure obligation breaches.

The Recommendation recital could formulate the above-mentioned proposal as follows:

> Episodic disclosure obligations occur in an instantaneous, rapid and unpredictable way and have an immediate impact upon share prices and investor decision-making strategies. Giving these aggravating disclosure circumstances, breaches in this framework should attract a more rapid and efficient form of enforcement. Administrative sanctions are more dynamic and rapid than civil and criminal sanctions. National laws should take into account these aggravating disclosure circumstances and enhance administrative sanctions. Member States should adopt more stringent administrative sanction rules and enable national competent authorities to impose higher penalties taking into account the aggravating disclosure circumstances present in episodic disclosure.

The Recommendation article could be worded in the following way:

> Member States should adopt more stringent administrative sanction rules and enable national competent authorities to impose higher penalties taking into

[114] *See* the analysis contained *supra*, Section 2.3.

account the aggravating disclosure circumstances present in the breach of periodic disclosure obligations.

Nevertheless, although national laws will continue to adopt different maximum levels of pecuniary sanctions, the *ad hoc* accentuation could set off a regulatory 'race to the top' trend that in turn could trigger indirect convergence amongst regulators given the benefits of the proposed scheme. Indeed, the gradual increase in amounts imposed can create a cascade of similar enforcement rates in the long term in jurisdictions that are less likely to use the full potential of dissuasion in pecuniary sanctions. It is this *de facto* convergence that can be framed at an early stage with the adoption of our proposal that may be even more important than a pure *de jure* convergence of applicable rules at the EU level.[115]

5. Conclusion

Disclosure obligations are triggered at different moments in time depending on circumstances as well as various corporate strategies with regard to their content, opportunistic character and potential impact on investors. Our article has endeavoured to formulate and test the hypothesis that companies manipulate time when they decide to violate disclosure obligations and transmit incorrect information or omit the disclosure of correct information to the market. The applicable legal provisions in the area of sanctions must therefore take account of the strategies, target them better and adopt a much more sophisticated approach when dealing with illegal practices. Under this condition, the applicable legal provisions in this area will become a greater deterrent to any further breaches of disclosure obligations.

In Section 2, the article attempted to frame an alternative view of the relationship between time manipulation and sanctions, and defended a new experimental framework for the creation of more targeted sanctions in capital markets law. In Section 3, the article analysed the current divergence in legal provisions applicable to prospectus, periodic and episodic disclosure obligations in the area of civil liability as well as criminal and administrative sanctions. It also focused on some

[115] 'If the level of enforcement intensity as well as the level of direct regulatory costs is higher in some jurisdictions than in others, then *de facto* regulatory convergence is unlikely to occur even if *de jure* convergence does': Jackson, *supra* n. 6, at 281.

harmonisation trends at the EU level and attempted to show their limited character, as well as the further need for more courageous political initiatives. In fact, in order to ensure a minimum of rigour at the EU level, while respecting the practical difficulties of minimum or even maximum harmonisation provisions in the area of sanctions, our article proposed (in section 4) a new scheme that could indirectly trigger a 'race to the top' convergence trend amongst national laws.

By introducing 'aggravating disclosure circumstances' and permitting courts and national competent authorities to increase the amount of sanctions depending on the time framework surrounding a breach in disclosure obligations, the legal framework will have an additional basis to become more responsive and more sophisticated in the treatment of corporate strategies exploiting the time element when engaging in illegal practices. In order to ensure transparency of financial information in capital markets, legal provisions must become more responsive to the increased market sophistication and rapidity with which information is disclosed. The ongoing search for more reactive and targeted ways to sanction deviating behaviour strengthens the argument for the adoption of these schemes. It also favours a different approach from the traditional view of the generic character of sanctions that are invariable regardless of the obligation violated.

Increasing the sophistication of capital markets law by allowing courts and regulators to modulate the severity of sanctions based on a much more modern approach, as explained in our article, will ultimately lay the grounds for a common perception of the usefulness of sanctions at the EU level, while respecting the current divergence and overcoming the persisting obstacles to formal harmonisation. While this inherently experimental conceptualisation cannot be reasonably expected to receive unanimous approval from readers, especially in the absence of empirical studies in its favour, it is hoped that this doctrinal contribution will be seen as a first attempt to trigger a debate around the relationship of time and sanctions in the area of disclosure obligations. It is also hoped that the reflections on the above-mentioned topics and the modest proposals for shaping a new sanctions framework will help strengthen a slow but steady cultural change, related to the legal frameworks' existing possibilities, to make their provisions more sophisticated in order to combat highly complex and conceptually advanced corporate strategies. The creation of this common perception and the coordination of the severity of sanctions based on indirect criteria, used at the discretion of courts and regulators on an *ad hoc* basis, may well be

able to offer a viable alternative to the pressing need to find new ways to better sanction defective disclosure tactics.

We believe that our proposals serve the purpose of building a common perception of the necessity for optimal sanctions while triggering *de facto* harmonisation trends at the EU level. Nevertheless, the main doctrinal contribution should be seen as a mindset for the development of such proposals globally in the distant future.