INVESTOR LOSSES

A Comparative Legal Analysis of Causation and Assessment of Damages in Investor Litigation

Elke Vandendriessche
## CONTENTS

*Preface and Acknowledgements* ................................................................. v  
*Abbreviations* ....................................................................................... xvii  
*Table of EU Legislation* ........................................................................ xxv

**Introduction & Research Agenda** .......................................................... 1

I. Introduction .......................................................................................... 1  
II. Research Questions, Scope and Structure of the Research .................. 4

**PART I.**  
PRIVATE ENFORCEMENT OF EU CAPITAL MARKET LAW:  
EU AND NATIONAL LEGAL FRAMEWORKS ........................................ 9

**Chapter I.**  
EU Capital Market Law from an Investor Protection Perspective: Legal  
Framework and Paradigms ...................................................................... 11

I. Rational Investors, Allocative Efficiency and the Information  
Paradigm ................................................................................................ 11  
II. Issuer Disclosure Obligations ............................................................... 14  
A. Elimination of information asymmetries in EU capital  
market law ............................................................................................ 14  
B. Market disclosure in the light of market efficiency and the  
price-building process of securities .................................................. 21  
III. Distribution of Financial Instruments Through Intermediaries:  
Information Obligations and Rules of Conduct .................................. 23  
A. Collective investment funds regulated by UCITS ......................... 24  
B. The Alternative Investment Fund Managers Directive (AIFMD) .... 25  
C. Investment services governed by MiFID II ................................... 26  
1. General overview .......................................................................... 26  
2. Rules of conduct .......................................................................... 29  
D. The Packaged Retail Investment Products Regulation (PRIIPS)  
and the Key Information Document (KID) ...................................... 35  
IV. Conclusion – The Continued Evolution of the Investor Protection  
Legal Framework: the Information Paradigm Under Pressure .......... 36
Chapter II.
Private Enforcement of EU Capital Market Law – European Legal Framework ........................................... 45

I. Goals of Enforcement: Deterrence and Compensation ........................................... 45

II. Enforcement Regimes: the Public v. Private Enforcement Debate ................................. 48
A. Overview: legal theory ........................................................................................................ 48
B. The law matters approach ................................................................................................. 53
C. Resonance of the private/public enforcement debate in the EU ...................................... 56

III. Private Enforcement of EU Capital Market Law ......................................................... 60
A. Private enforcement of investor protection measures: the impact of EU capital market law ......................................................................................................................... 61
1. Private enforcement of obligations imposed by EU capital market law .............................. 61
   a. Minimalistic approach in EU capital market legislation ........................................... 61
   b. Increased attention for (private) enforcement of EU capital market law ...................... 66
   c. Conclusion: the (limited) impact of the EU capital market legislation on the national liability regimes ........................................................................................................ 69
2. The division of powers justifying the absence of civil liability law in the EU capital market law directives? ............................................................................................... 72
   a. Division of powers between the EU and the Member States: overview ....................... 72
   b. Principles of subsidiarity and proportionality .............................................................. 74
   c. Reluctance and restraint vis-à-vis the “Europeanization” of private law ...................... 75
   d. Conclusion: broad yet functional EU lawmaking powers ........................................... 77
B. Private enforcement of investor protection measures: the role of the EU courts .............. 78
1. Enforcement of EU law: the role of the CJEU and ECFI ............................................. 78
   a. Decentralized system of EU law enforcement .......................................................... 78
   b. Role of the EU courts in centralizing EU law enforcement .................................... 80
      i) Enforcement of EU law in national courts ......................................................... 81
      ii) Europeanization of remedies and procedures in the light of the principle of adequate judicial protection ................................................................. 84
         (a) Principles of effectiveness and equivalence .................................................... 85
         (b) Tension between the preserved discretion of the Member States and the principle of adequate judicial protection ........................................................... 87
   c. Assessment and outlook .............................................................................................. 92
2. Private enforcement of EU capital market law in the light of the EU courts’ case law ....... 94
a. The clear-cut case of explicit provisions on civil liability law in EU capital market legislation ........................................ 94
b. The less clear-cut case of MiFID and the Market Abuse Regulation/(former) Market Abuse Directive I .................... 96
   i) Indirect effect of investor protection measures .......... 97
   ii) Direct effect of investor protection measures .......... 101
C. Conclusion .............................................................. 106
IV. Private Enforcement of EU Capital Market Law: Conclusion ........ 107

Chapter III.
Private Enforcement of (EU) Capital Market Law - National Legal Frameworks .......................................................... 111
I. Introduction: Remedies Under the Member States' General Liability Laws ............................................................. 112
   A. The traditional division between non-contractual and contract law in the Member States ........................................ 112
   B. Investor redress: compensatory damages in non-contractual liability law ......................................................... 113
   C. Investor redress: contractual remedies ....................... 121
      1. Damages ............................................................ 121
      2. Annulment, invalidity or unenforceability of contracts or transactions ......................................................... 122
         a. Violation of mandatory rules affecting the validity or enforceability of the contract or transaction .......... 122
         b. Defects of consent affecting the validity of contracts ..... 126
         c. Assessment ....................................................... 127
      3. Other contractual remedies: non-imputable transaction(s), rescission and termination of contract .......... 129
   D. Investor redress: precontractual liability .................... 130
II. Causation, Recoverable Loss and Assessment of Damages in the Member States' Private Laws ........................................ 135
   A. Recoverable loss .................................................. 135
      1. Concept of recoverable loss .................................. 135
      2. Components of investor compensation: heads of damages/types of loss ..................................................... 140
         a. Recoverable loss: suffered harm and lost profits .......... 140
         b. Interest ........................................................... 142
         c. Recoverable costs .............................................. 142
         d. Damages for pain and suffering: moral damages .......... 143
   B. Requirement of causation in civil liability law: concept and general principles ........................................... 146
      1. Causation in civil liability law: concept and general principles 146
PART II.
COMPENSATORY INVESTOR SUITS IN INVESTMENT SERVICES: CONCEPT AND ASSESSMENT OF CAUSATION AND LOSS

Chapter I.
The Requirement of Transaction Causation in Investor Suits for Defective Investment Services

I. Transaction Causation in Investor Suits: the Reliance Model

II. The Establishment of Transaction Causation in Financial Services Litigation in Courts: Burden of Proof and Facilitations vis-à-vis (Retail) Investors

A. Stringent approach towards transaction causation

B. Facilitations through traditional techniques in civil liability law

1. The introduction of rebuttable presumptions of reliance
   a. The German Vermutung aufklärungsrichtigen Verhaltens
   b. Belgian statutory presumption of causation
Chapter II.
The Concept and Assessment of Recoverable Loss in Investors Suits Concerning Defective Investment Services .................................................. 233

I. Compensation of Investor Loss: General Principles ..................... 233

II. Actually and Certainly Suffered Investor Losses ....................... 235
   A. Overview and illustrations ...................................... 235
   B. Liquidation of investments: prerequisite for the compensation of investor loss? .......................................................... 240
      1. Overview: actual and certain investor loss .................. 240
      2. Imperfect solution to investor strategic behavior .......... 242
      3. Incomplete solution in the light of the wide range of possible claims ................................................................. 243
      4. Final assessment: aligning risks with responsibility for investments ................................................................. 244

   C. Reference date: adequate investor compensation and (re)allocation of investment risk .................................................. 245
      1. Order execution: reference date ................................. 245
      2. Investment advice and asset management .................... 252

III. Determination of the Hypothetical Alternative Scenario ................ 255
   A. Rescission/rescissory damages .................................... 256
   B. Hypothetical alternative scenario: determination ............ 261
      1. Overview ......................................................... 261
      2. Reconstruction of hypothetical investments: reference portfolio ............................................................... 263
PART III.
THE CONCEPT OF CAUSATION AND RECOVERABLE LOSS IN
THE CONTEXT OF DEFICIENT MARKET DISCLOSURES

Chapter I.
The Concepts of Loss and Causation in the Context of Deficient Issuer
Information: Transaction Model.

I. The Concept of Causation in the Transaction Model
   A. Transaction causation in the light of deficient issuer
      information: general overview
   1. The requirement of having read the misleading information
   2. Reliance on the deficient information
      a. Materiality versus reliance
      b. Assessment of reliance: criteria
   B. Transaction causation in the context of prospectus liability
B. Fear of opening the floodgates and policy considerations ........... 363
C. The potential impact of the EU principle of effectiveness
   (effet utile) ........................................................................... 366
   1. The principle of effectiveness in the light of Article 7
      Transparency Directive ..................................................... 367
   2. Differentiated liability regimes for periodic and ad hoc
      disclosure obligations? ..................................................... 369

IV. Assessment and Concluding Remarks .................................... 370

Chapter II.
An Alternative Approach to Investor Losses Following Secondary
Market Misstatements: the Market-Based Approach ..................... 375
I. The Market Model: Protection of Market Integrity ..................... 376
   A. The market model: conceptual underpinnings .................... 376
   B. Causation and loss following misleading disclosures in the light
      of the market model ....................................................... 378
II. Origin of the Market-Based Approach: the Efficient Capital Market
    Hypothesis and the Genesis of the US Fraud on the Market-Theory .. 380
    A. Overview ...................................................................... 380
    B. Financial-economic theory: the efficient capital market
       hypothesis ................................................................. 381
    C. The development of the US fraud on the market doctrine ....... 382
       1. Rule 10b-5: context and background ............................ 383
       2. Reliance in the context of Rule 10b-5 ......................... 385
       3. Fraud on the market: the adoption of ECMH by the US
          Supreme Court ....................................................... 387
          a. Fraud on the market as a presumption of reliance ...... 387
          b. The notion of "efficient markets" ......................... 389
          c. Rebuttal of the FOM presumption ..................... 391
       4. Assessment of FOM in the light of the reevaluated insights
          on market efficiency ................................................. 392
          a. The criticism and doubts casted on the ECMH ........ 392
          b. Uncoupling ECMH from the market model .......... 395
    D. Interim conclusion: the US-originated market model assessed .... 395
III. The Implementation of the Market-Based Approach in the EU
    Member States .................................................................. 398
    A. The adoption of the market-based approach by the German
       Supreme Court ............................................................ 399
       1. Rejection of the US fraud on the market doctrine by the
          German Supreme Court .......................................... 399
       2. The German IKB decision unlocking the door to an
          alternative causation concept confined to §§37 b, c WpHG .... 401

xv
C. Interim conclusion: the concept and calculation of recoverable loss in the market-based approach ............................................. 457
V. Applicability of the Securities Pricing Model to Prospectus Liability Cases ................................................................. 457
VI. The Case for Collective Redress Mechanisms in EU Member States ............................................................. 462
VII. The Market-Based Approach Assessed on Its Merits: Effective Redress and Deterrent Effect ............................................... 470
   A. Circularity and limited recovery: the compensatory rationale undermined? ................................................................. 471
      1. The circularity problem ......................................................... 471
      2. Limited compensation ......................................................... 477
         a. Interplay between damages, settlements and insurance coverage ................................................................. 478
         b. Limited compensation: assessment ......................................... 484
   B. Deterrence ................................................................ 487
   C. Conclusion on the US securities litigation experience ................. 491
   D. Solutions and alternative approaches to improve the enforcement of securities laws ......................................................... 492
      1. Increased enforcement of director and executive responsibility ................................................................. 492
      2. Increased managerial responsibility: mechanisms and techniques ................................................................. 495
         a. Derivative shareholder actions ................................................... 495
         b. (Ex ante) Signaling mechanisms: the corporate governance approach ................................................................. 498
         c. Incomplete or partial insurance coverage ......................................... 499
      3. Organization of (more) effective enforcement systems: a hybrid role for public supervisors? ................................. 503
   E. Conclusion: what are the Member States and/or the EU to make of the private enforcement debate in the context of capital market disclosures? ......................................................... 510

PART IV.
CONCLUSIONS ......................................................................... 513

Addenda .................................................................................. 521
Bibliography ............................................................................. 523