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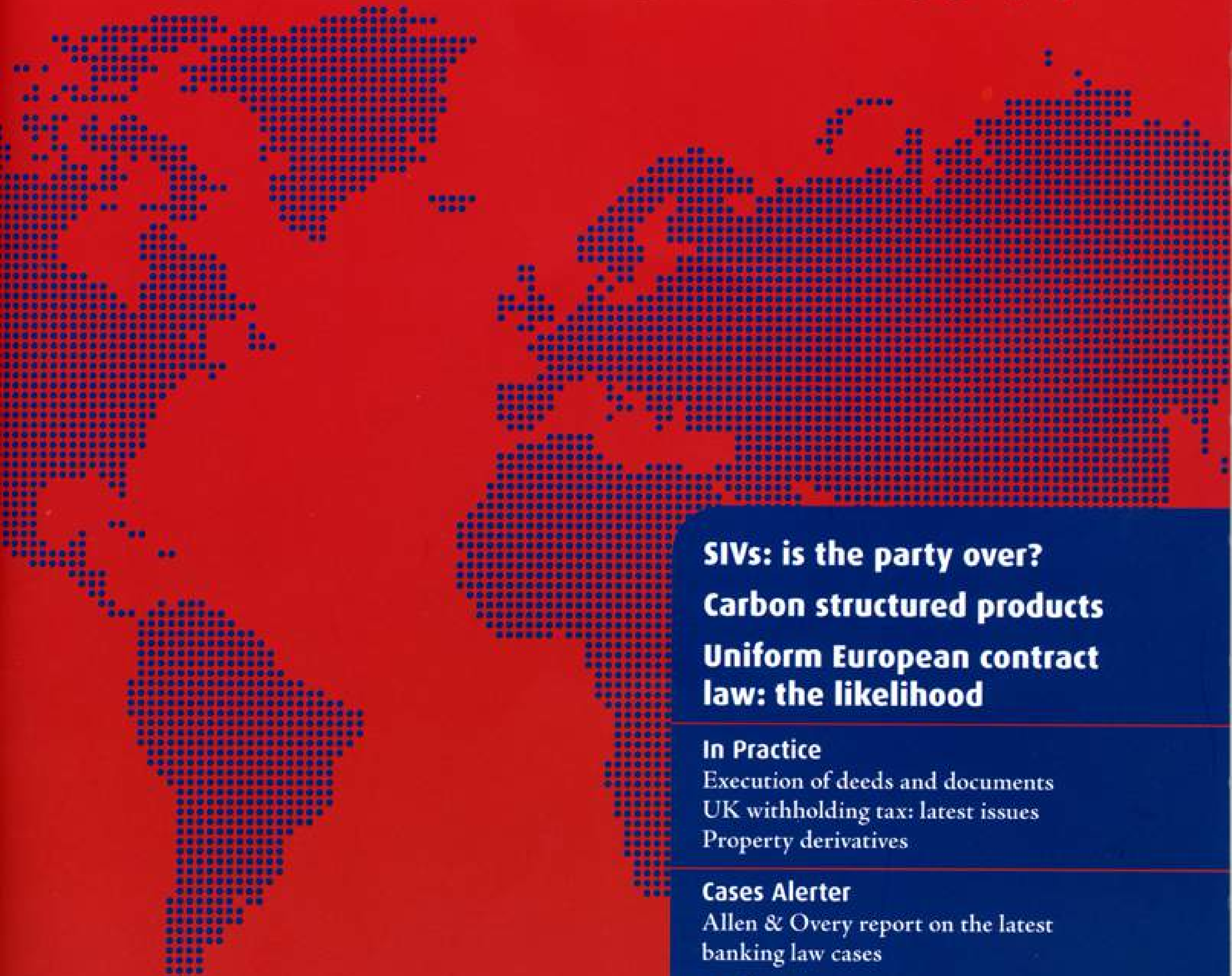

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KEY POINTS

- The European passport, as provided for in the Prospectus Directive ('PD'), enables prospectuses that have been approved by the competent authority of the home member state to be used in any other state of the European Economic Area ('EEA').
- This concept enhances cross-border financial services, but it may also conflict with investors' interest.
- This conflict is mainly due to the language regime of the Directive, which reduces both the transparency and comprehensibility of financial information and also the legal enforceability of prospectus liability.
- The European Court of Justice ('ECJ') may, however, give greater weight to investor protection. This would be in line with the case law on the Unfair Terms Directive where the idea of transparency and comprehensibility is used as a key concept.

Authors Peter Mattil and Dr Florian Möslein

The language of the prospectus: Europeanisation and investor protection

This article focuses on the language regime for securities prospectuses under European law, and describes problems that can be expected in practice.

INTRODUCTION

The Prospectus Directive ('PD') regulates contents, approval and publication of prospectuses for securities to be offered to the public or admitted to trading on regulated markets. Above all, it introduces the so-called notification procedure for prospectuses. This procedure enables one single prospectus, once approved by the competent authority of the home member state, to be used for public offer or listing in any other state of the European Economic Area ('EEA'). This regime may, however, conflict with the idea of investor protection. German investors, for instance, may be confronted with prospectuses that are not drafted in German. If investors need to have the prospectus translated and are possibly referred to a foreign legal system, this will critically impede legal actions. Investor protection would instead require that prospectuses be translated at the expense of the issuer into the language of the host member state, and that the jurisdiction and statutory provisions of the host country apply. The idea of consumer protection is much less incorporated into the PD than in most other private law directives. Small investors need to be aware that they will often be unable to enforce their rights with reasonable effort – unless the European Court of Justice ('ECJ') strengthens consumer protection in this area as well.

THE LANGUAGE REGIME IN THE PROSPECTUS DIRECTIVE

From admission to notification

The European domestic market was created to enhance cross-border financial services. After the implementation of the so-called European passport for credit institutions (deposits and credit transactions), certain insurances and investment funds, the European passport for securities services companies followed suit. This system of the European Passport implies, in general, that admissions that have been granted by the home member state are valid in other member states as well. Therefore, only one admission is required throughout Europe. The PD, which has now been transposed by all the member states, finally introduced the European Passport for securities prospectuses. Previously, an admission regime applied and prospectuses that had been approved in any EEA state required additional approval in all the other member states. In addition to the foreign approval certificate, the translation of the prospectus was a basic requirement, at least, for example, according to German law.

The PD, on the other hand, introduced the so-called notification procedure and merely demands that the approved prospectus will be filed with the competent authority of the home member state and be made available to the public in advance of the offer or admission to trading. According to art 17 PD, the prospectus, approved by the home member state, and any supplements to it are valid for the public offer or admission to trading in any host member state, provided that the competent authorities of the host state are notified. The competent authorities in the host state no longer undertake any additional approval procedure.

This system of bare notification runs the risk, however, that issuers will take advantage of lower regulatory standards than would otherwise apply in their home member state. They can do so by merely requiring approval in another EEA member state with a more favourable regulatory regime. While the European legislator prevented such kind of abuse with respect to other passports, it has not done so in the case of the PD. At least, the formal prospectus requirements have been simultaneously harmonised throughout Europe and cannot therefore be evaded (in particular, the format of prospectus information, publication modalities, and the dissemination of advertisements).

Use of languages (art 19 PD)

Furthermore, the PD modified the language regime that applies to prospectuses. This fundamental change is of key importance for an efficient European capital market, since investors can only make rational investment decisions if they are provided with adequate information. Their level of information will depend significantly on the comprehensibility of the securities prospectus. Hence, it is necessary to avoid a Tower of Babel confusion of languages.

Case groups

The Directive regulates the language in which the prospectus will be drafted in art 19. The major advantage of the new rule is that issuers save substantial translation costs. As long as securities are publicly offered or are only admitted in the home member state of the issuer, the prospectus only needs to be drafted in any additional language accepted by the competent authority of the home member state (art 19 para 1 PD). Regarding cross-border offers though, the competent authorities of each host member state are no longer in a position to require the translation of the whole prospectus into its official language(s). This is only required for the prospectus summary. The language in which the prospectus is to be drafted depends significantly on whether the public offer or admission request will be made exclusively in the host member state or in the home member state as well. In the first case (offer or admission exclusively abroad), issuers, offerors, or persons asking for admission have a choice between the language accepted by the foreign authority and the 'language customary in the sphere of international finance' (art 19 para 2 PD). However, where the prospectus is to be presented to the competent authority of the home member state which is responsible for the approval of the prospectus according to art 13 para 1 PD, it needs to be drafted in one of the languages accepted by this authority as well as either in the language accepted by the foreign authority or in the 'language customary in the sphere of international finance' (art 19 para 2 PD). Thus, in this second case (offer or admission request in the home member state as well), the same choice exists, but the prospectus must *additionally* be drawn up in a language accepted by the competent authority of the home member state (art 19 para 3 PD).

The requirement of a 'language customary in the sphere of international finance'

The key qualification is the possibility of using a 'language customary in the sphere of international finance'. Any essential advantage for the issuer will only come into being if such language is used. Only this choice will avoid translation costs, which are regarded as the main obstacle for cross-border offers of securities as well as for a truly European capital market.

Most authors assume, often implicitly, that it is the English language to which the Directive refers. The Directive does not, however, explicitly mention the English language and does not even refer to *the* language, but to *a* 'language customary in the sphere of international finance'. There is thus some room for interpretation. Hence the question arises whether the term is to be interpreted with a view to the whole European market or only to the area where the respective securities are offered. In the latter case, it would suffice that the relevant language is the language customary for cross-border transactions in the respective member states. For the approval of a prospectus by the authority in Luxembourg, for instance, not only English but also French and German might be taken into account, if the securities are subsequently offered in Germany and Austria. Indeed, the European Commission seems to prefer such a 'relative' definition and would obviously accept German as a language 'customary in the sphere of international finance' for the securities issue in Central Europe. However, this approach does not answer the point that securities, once approved, may circulate freely across Europe. This principle of free circulation, as laid down in art 17 para 1 PD, excludes any 'regional' interpretation of the language requirement *a limine*.

Supplementary effects of the language regime

The language regime of art 19 PD is not only relevant for prospectuses as such, but also for any documents related to the prospectus, as well as for advertisements and supplements to the prospectus. Moreover, similar language regimes apply to other forms of (periodic) capital market information.

Pursuant to its art 11, the PD provides that a prospectus may refer to external documents ('incorporation by reference'). However, the Directive does not specify the language in which these documents need to be drafted. The regulation implementing the Directive (Commission Regulation No 809/2004 of 29 April 2004) merely stipulates in its art 28 para 2 that reference documents 'shall be drawn up according to the provisions of art 19' of the PD. A 'split' language choice could save substantial translation costs; for example if periodic information could be given in German, while the prospectus could be drafted in English for an issue abroad. Such bilingual documents will certainly be more difficult for the authority to handle, in particular when it comes to checking the coherence of prospectus and reference documents. Furthermore, the comprehensibility of the whole set of information will significantly decrease. Since the regulation implementing the Directive also provides that, when incorporating information by reference, prospectus drafters 'shall endeavour not to endanger investor protection in terms of comprehensibility and accessibility of the information' (art 28 para 5 Regulation), a split language choice should be restricted to exceptional cases that need to be justified with good reason.

Supplements to the prospectus and advertisements pose similar problems. The former need to be drafted in the same language as the prospectus. As for the summary, which can be made available in different languages, the PD specifically demands respective supplements in all language versions ('summary, and any translations thereof', see art 16 para 1 PD). This demonstrates that the European legislator assumed the prospectus and supplements would be drawn up in the same language.

A different regime might apply, however, for advertisements, even though they also refer to the prospectus, and even though the Directive underlines the need for consistency with any information given in the prospectus (art 15 paras 3 and 4 PD). Advertisements are launched in the media of the host member state and are addressed directly to investors. Issuers must have the chance to 'speak their language', even if the prospectus has been drawn up in another language. This multilingualism can require significant translation efforts of the competent authority of the home member state. Among other things, the authority has to check whether the advertisements accord with the information given in the prospectus (art 15 para 6 PD).

The language question is also important for *ongoing financial information*, namely for periodic information (annual and half-yearly financial reports as well as interim management statements, arts 4-6 Transparency Directive, ('TD')), for information on major shareholdings (arts 9-16 TD), and for ad-hoc publicity (art 6 Market Abuse Directive). Article 20 TD lays down a standardised regime for all 'regulated' information (including ad-hoc-publicity, according to art 2(1) lit k TD). This regime roughly corresponds to the solution given by the PD, as it distinguishes the same case groups and provides for the same language requirements and options. However, this rule gives rise to a 'double option', because the language choice for the prospectus and for all other regulated information does not necessarily have to be the same: A foreign issuer whose securities are (exclusively) admitted in Germany can draft the prospectus in English, for example, but may very well provide all the other financial information in German. Article 20 para 7 TD addresses the procedural core problem: Which party must bear the translation costs for disputed capital market information? The Directive does not give an answer to this question, but explicitly leaves the question to national procedural law (delegation to member states).

CHOICE OF LANGUAGE AND PROTECTION OF INVESTORS

Practical problems

As a consequence, the prospectus no longer needs to be translated in the case of public offers or trading admissions of securities abroad. It can instead be drafted in a language accepted by the competent authority of the host member state or in a language that is customary in the sphere of international finance. This might, however, lead to substantial problems, especially for small investors. These problems can be illustrated by the following practical example: an issuer based in France sells securities to small investors in Germany; the minimum investment sum is €1,000. The prospectus contains approximately 220 pages and is drawn up in English and French with two columns. However, the prospectus also includes whole pages in either French or English. In the 15-page German summary, which contains only general risk information, the investor learns, among other things, that he might be obliged to translate the prospectus, that the prospectus is to be governed by French law and that any disputes are to be made subject to the exclusive jurisdiction of the Paris Civil Court. This prospectus is not fictitious, but is currently in use in Germany.

Incomprehensibility and effort of prosecution

The sample prospectus referred to above is addressed at small investors in Germany (consumers) but such investors are unlikely to be able to understand the prospectus in detail. In order to discover whether the prospectus is complete or incorrect with respect to its content, the aggrieved investors must arrange a full translation. In the case of a lawsuit in a German court, the content of the prospectus would have to be provided, together with the statement of claim, in a translated version. The translation costs will amount to a five-figure sum. If the defendant denies the correctness of the translation, the court will order its own translation. The costs will be much higher than the sum that small investors are likely to claim (as the minimum subscription was no more than €1,000).

"Article 20 para 7 TD addresses the procedural core problem: Which party must bear the translation costs for disputed capital market information?"

Applicable law

If there is a dispute, the sample prospectus referred to above provides that French law will apply. After an expensive translation, the claimant will have to prove the incorrectness and incompleteness of the prospectus under French law. This raises the question of whether the choice of French law is valid or whether German law will be applied in order to protect the consumer. However, the invalidity of the choice of law clause is not defined by German law, but, according to the German conflict of law rules (art 31 para 1 *Einführungsgesetz zum Bürgerlichen Gesetzbuch* ('EGBGB') – ie by the law which would be applicable if the contract or the clause were effective (thus, in the sample case, according to French law). Therefore, the investor will have to examine the prospectus, at least preliminarily, under French law. He will have to consult an attorney in France, who must be capable of communicating with him and who, of course, will need to be specialised in financial market law. This might be difficult.

Article 6 or art 34 EGBGB might bar the application of French law. Under German law, an imperatively international character is generally not attributed to prospectus liability, on the grounds that art 34 EGBGB covers only contractual, not tortuous, liability. The choice of French law could also be void according to art 29 para 1 EGBGB if it causes the investor loss of protection that is mandatory under German law. This applies to all mandatory rules that specifically aim to protect one contractual partner against another. However, art 29 para 1 EGBGB only deals with contracts concerning the provision of moveable goods and services, not with the provision of securities. Even if one assumes that the issuer also provides services (consulting, investment), these services will almost certainly not be provided in the state in which the consumer resides.

The application of French law does not necessarily imply that mandatory rules protecting the consumer will be circumvented. Generally, French law does provide investors with causes of action in respect of prospectus liability in the case of securities acquisitions.

According to the majority view, there is no rigid tie to the consumer's state of residence; and the choice of law is not invalid. The law rather dictates the minimum

Biog box

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protection that must be granted in the consumer's state of residence. However, the consumer will still have the burden of being confronted with French law, which will probably be unknown to him. In either case, small investors face difficult legal questions and unreasonable effort.

Jurisdiction

Whenever the substantive review of the prospectus (under German or French law) reveals that the information does not comply with the applicable rules, the investor might want to bring an action for breach of the terms of the prospectus. He will, however, be confronted with a jurisdiction clause in the prospectus that declares that the Paris Civil Court has jurisdiction. Although such jurisdiction clause is generally allowed, according to art 17 Council Regulation No 44/2001, it is only effective if the agreement (in this case, the prospectus) is entered into after the dispute has arisen or if it allows the consumer to bring proceedings in courts other than those indicated in the Regulation. Neither is the case in our example. So the court which has jurisdiction is defined by art 15 et seq Reg 44/2001. These rules allow proceedings to be brought in the state where the consumer is domiciled, provided that the commercial activity of the contractual partner (the issuer) is directed to that member state. Accordingly, it will be possible for the consumer to bring proceedings in Germany as the sample prospectus was notified to the German supervisory authority by the French competent authority for use in Germany.

In practice, the circumstances leading to a host member state domestic jurisdiction and to the application of German law will be disputed between the parties on a regular basis. It will often be denied that the investor is a consumer and that the action of the offeror is directed towards the domestic market. There is also a strong tendency in courts to deny their own responsibility. Even if the investor establishes a German jurisdiction in the sample case, the lawsuit must be decided according to French law. The problem of the prospectus translation also remains. If the defendant denies the correctness of the translation, a translator appointed and sworn by the court must also be involved.

Legal diversity with respect to prospectus liability

The issuer in the EEA can use a standardised prospectus in each member state, but the rules on the prospectus liability of publishers, guarantors, and other responsible persons have not yet been harmonised at the European level. In its art 6, the PD merely stipulates that at least some of these persons must be held liable under national law. Nevertheless, national regimes diverge to a substantial degree with respect to the potential scope of claims, causation, foreclosure and limitation. Under German law, for instance, the responsible persons are held liable according to the principles of civil law prospectus liability and according to the respective statutory rules in the Securities Prospectus Act, Securities Sales Prospectus Act and Stock Exchange Act.

Where the securities are traded, the buyer of the securities can ask for the transfer of the securities by refunding the purchase price insofar as it does not exceed the first offering price of the securities. Furthermore, it is important that the commercial transaction is entered into after the publication of the prospectus and within six months after the first introduction of the securities. Claims become statute-barred within one year from the time that the buyer discovers the incorrectness or incompleteness of the prospectus information, but at the latest, three years from the publication of the prospectus.

Other member states apply completely different rules. In Denmark, for instance, there is no special regime with respect to prospectus liability, and remedies are available only under the precondition that fault or negligence are established. In France, no special regime exists either, but the general contract or tort liability rules apply. Furthermore, investors cannot proceed against the company (issuer) in every member state due to the principle of maintenance of capital or on grounds of creditor protection (as in Sweden). By contrast, the potential liability of board members, as well as that of certified accountants, is explicitly provided for in Portuguese law. Whereas, in Greek law, this is not the case as managers, consultants and accountants are not personally liable. In Portugal, claims of prospectus liability become statute-barred within six months. Only some member states provide for the collective action of investors. The restitution of attorney and court fees in the case of a judgment is subject to very different rules as well. German law provides for a privileged seizure of assets in case of injunctions, as opposed to most other member states.

Investor protection

The introduction of the European passport and the new language regime make it difficult for (small) investors to enforce their claims. According to art 3 para 1 lit EC Treaty, the European legislator is required to take into account the idea of consumer protection when enacting directives and regulations, as are Community institutions, according to art 153 EC. It is not clear whether any balancing of investor and offeror interests took place when the PD was enacted. The translation costs could have been attributed to issuers, who are not only economically stronger, but also benefit from the fact that they are able to address small investors in other member states. It is, however, unlikely that the ECJ will abrogate the Directive, given that it attributes a wide margin of appreciation to the legislator. The ECJ might, however, mitigate some practical burden and thereby safeguard investor protection. This would correspond to existing case law relating to the Unfair Terms Directive.

Certain procedural provisions concerning jurisdiction clauses and foreclosures have been rejected on the grounds that they would make legal action too difficult for consumers. Generally, the idea of transparency and comprehensibility is clearly a key concept of the Unfair Terms Directive and of European Private Law in General: contracts must be drafted in a transparent and comprehensible language. Consumers must be able to act on an informed basis. Even though these rules do not apply directly to securities prospectuses, they express a more fundamental idea, that consumers – including investors – need to be protected against opaque terms. ■